



STATE EMPLOYEES'
RETIREMENT SYSTEM
OF ILLINOIS

1985 ANNUAL REPORT

STATE EMPLOYEES'
RETIREMENT SYSTEM
OF ILLINOIS

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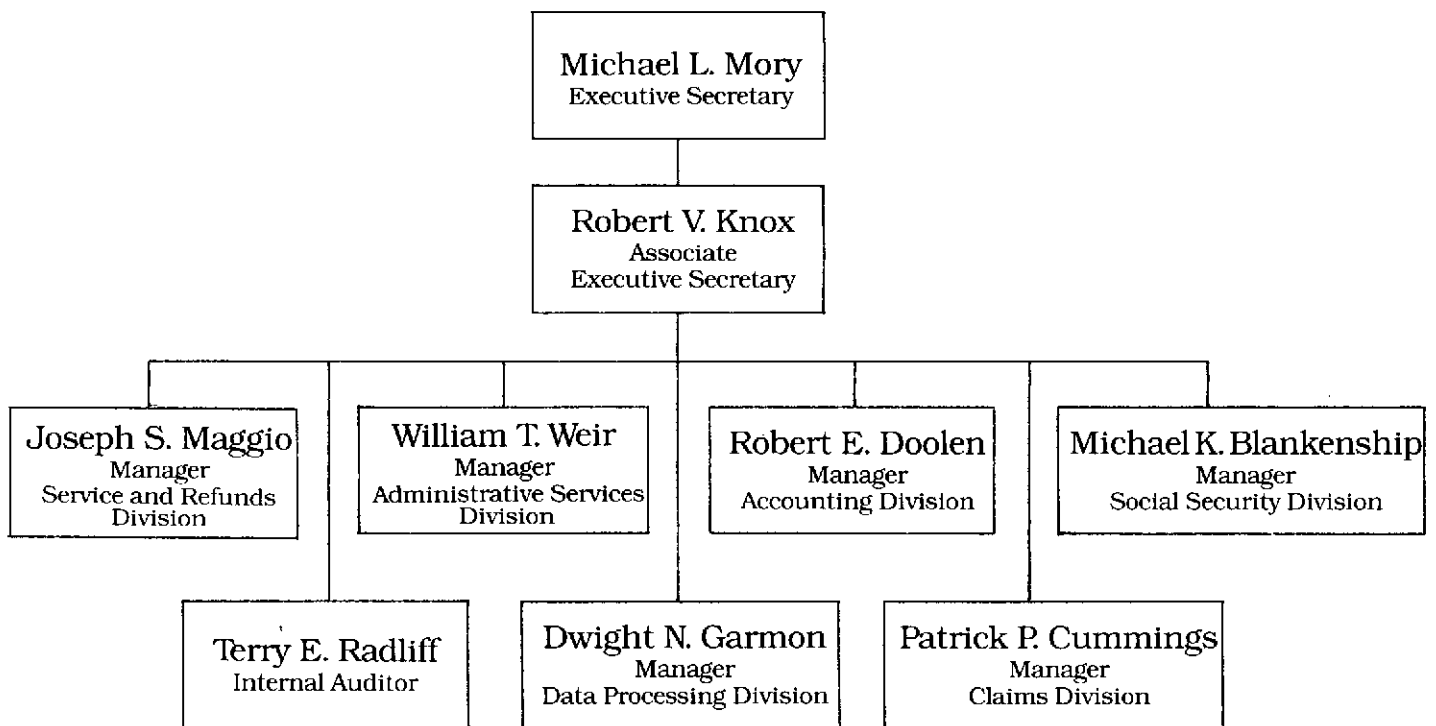
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BOARD OF TRUSTEES



From left to right: E. Allen Bernardi, State Employee appointed by Governor; Joseph T. Pisano, State Employee appointed by Governor; Alice Kirby, representing Roland W. Burris, Comptroller, State of Illinois; Michael L. Mory, Executive Secretary; Mark Gallagher, representing Robert L. Mandeville, Director, Bureau of the Budget, State of Illinois.

ADMINISTRATIVE STAFF





To: Board of Trustees
 Governor
 Active & Retired State Employees
 Other Interested Parties

Financial Condition

As of June 30, 1985, net assets of the State Employees' Retirement System of Illinois were \$1.707 billion. The System's total actuarial accrued liability amounted to \$2.868 billion resulting in an unfunded liability as of the end of the fiscal year of \$1.161 billion. A comparison of the System's funding status as of June 30, 1985 and 1984 follows:

Fiscal Year	1985 (Billions)	1984 (Billions)
Total Actuarial Liability	\$2.868	\$3.127
Net Assets	1.707	1.581
Unfunded Liability	1.161	1.546
Percentage Funded	59.5%	50.6%

The substantial improvement in the System's financial condition as reflected in the above exhibit results almost entirely from changes made during FY-85 to the economic assumptions utilized for valuation purposes. At the recommendation of the actuary, the interest assumption, which reflects anticipated future investment return, was increased from 7½% to 8%. At the same time, the level of increase in the future salaries of plan participants was assumed to decrease from 7½% to 6½% per year reflecting a lower level of future inflation. The effect of both of these changes decreased the actuarial accrued liability to such an extent as to result in a significant improvement in the System's funded status even though excess revenues over expenditures decreased between 1984/85 from \$172.5 million to \$126.0 million.

During the year, total revenues decreased \$36.1 million from \$310.1 million to \$274.0 million. This decrease was due primarily to a net realized loss on the sale of investments of \$14.8 million as compared to a gain of \$44.8 million during FY-84. Total expenses increased \$10.4 million during the year to a level of \$148.0 million. Benefit payments made to terminated/retired/disabled state employees and their survivors amounted to \$145.5 million representing 98.3% of the System's total expenses.

Employer Financing

During FY-85 the System received a total of \$94.5 million from the state of Illinois as compared to \$86.4 million during FY-84. Regular contributions made for funding purposes amounted to \$89.5 million for 5.7% of active member payroll. In addition, \$2.4 million was received as the System's share of distributions from the unclaimed property fund. A special appropriation of \$2.6 million represented the third installment called for by Joint Resolution 33 passed by the General Assembly as a result of midyear reduction in state contributions made during 1983.

Adequate funding of the five state-financed retirement systems was once again one of the primary issues before the legislative and executive branches of state government. Legislation identical to that vetoed by the Governor last year was reintroduced in the General Assembly and debated extensively during the 1985 spring session. These bills were held on third reading in both chambers, apparently based on action taken by the Governor to establish a special task force made up of representatives from both the public and private sectors to study the funding issue. The task force report is scheduled to be submitted to the Governor prior to the end of the calendar year. It is assumed after consideration by the Governor, that the task force recommendation or some variation thereof, will be submitted to the General Assembly for their consideration in the spring of 1986.

As stated in prior years, it is believed that the adoption of a long range funding program based on the ultimate obligations of the System is essential to assure future financial stability, as well as equitable apportionment of plan costs to each generation of taxpayers.

Investments

As of the end of the fiscal year, investment holdings of the System under management of the Illinois State Board of Investment had a market value of \$1.729 billion. Book value as measured on a cost basis was \$1.688 billion. This represents an increase of \$329.6 million and \$124.0 million measured on a market and cost basis. During the year the System earned net income of \$115.8 million and transmitted contributions to the Board for long term investment in the net amount of \$23 million.

In reviewing performance over the past three and five year periods, the Board has produced an annualized rate of return of 18.5% and 11.6% during those respective periods; substantially exceeding the System's actuarial assumption of 8%. Total rate of return achieved during FY-85 was 22.0%. The compound rate

of growth since inception of the Investment Board in 1970 is 8.1%.

During the past 12 months the Investment Board engaged in a major portfolio restructuring concentrated in the equity area. After receiving input from an outside consultant, a two-styled investment approach was adopted which involves a combination of both external and internal management. As a result of these changes, the Board anticipates better diversification and a lessening of volatility of the fund's equity portfolio thus creating an environment that may enhance future investment performance.

Benefits

The primary purpose of the System as contained in State statute is to provide an orderly means whereby aged or disabled employees may be retired from active service without prejudice or hardship. While total achievement of this goal is dependent upon many factors, the program which has evolved since establishment of the System in 1944 provides a comprehensive package benefiting not only retired and disabled State employees, but their families as well.

As of June 30, 1985, there were 20,969 retirement annuity recipients. The average retirement annuity was \$396.60 per month and was based on an average of 244 months of service. The average annuity for 1,819 state employees retiring during FY-85 was \$544.61 based on service of 242 months.

Of the more than 20,000 individuals receiving retirement annuities, 2,522 retirees had reciprocal service with other Illinois public retirement funds and used this service in conjunction with their state employment in computing their monthly benefit. In addition, 4,049 retirees received noncontributing service credit for periods of state service rendered prior to establishment of the Retirement System.

Surviving spouses, children and dependent parents of deceased members totalled 7,626 as of June 30, 1985. These include claims resulting from both occupational and nonoccupational deaths.

Disability benefits are provided by the System for both occupational and nonoccupational illnesses and injuries. Occupational disability benefits include 524 continuous payments averaging \$336.85 per month. In addition, claims for short-term disabilities resulting from occupational illnesses and injuries totalled 590. Nonoccupational disability benefits on a continuous basis averaged \$604.78 per month and were made to 1,210 individuals. Short-term nonoccupational disability benefits paid during FY-85 totalled 715.

Membership Services

An essential element of any employee benefit program is a coordinated and timely approach to communicating information to plan participants. This function has in the past and will continue in the future to have priority commitment of both time and financial resources.

The System's Field Services Program is a comprehensive approach consisting of various written publications and informational seminars designed to communicate the basic benefit program as well as introduce other issues of importance to active and retired members. During FY-85, annual statements of account which include benefit projections, social security estimates and beneficiary information were mailed directly to the residence of over 90,000 active and inactive members. Two separate newsletters containing information of a current events nature were also published twice during the year and furnished separately to active members and benefit recipients.

While the importance of written communications cannot be understated, the opportunity to question areas of uncertainty and expand understanding is best served by direct person-to-person contact. This opportunity is provided in the form of group seminars conducted at work locations throughout the state and consists of an audio-visual presentation with a question and answer period which follows. During the year, over 5,200 state employees attended these seminars which were presented in 191 locations.

Recognizing that the transition from active employment to retirement can be traumatic without proper planning, the System offers a two-day Preretirement Workshop which deals in depth with the planning process. This program is targeted for state employees who are from five to ten years away from retirement. During FY-85, 22 separate Preretirement Workshops were conducted and attended by 962 employees.

During FY-86, the System will update and republish the basic benefits booklet "Your Retirement System." A booklet will also be developed and distributed to both existing and new benefit recipients which will contain important information regarding their monthly payment. In addition, a new one-day Preretirement Program will be introduced which is specifically designed for employees who are within one or two years of retirement and have not had the opportunity to attend the two-day workshop. This new program will emphasize the financial aspects of preretirement planning as they may be applied over a short time horizon.

Legislation

While most of the legislation introduced during the

1985 spring session of the Illinois General Assembly affected the System's benefit program, the single biggest issue addressed again involved the investment of System assets in corporations doing business in South Africa. Several bills pertaining to this issue were introduced and although two bills reached the floor of the House, a vote was never taken. Although passage of some form of legislation addressing South Africa at the national level is possible, it must be assumed short of a federal preemption that the issue will again come before the Illinois General Assembly.

Several bills of an administrative nature were passed by the General Assembly and approved by the Governor. Two significant proposals were also signed into law. The first involving security employees of the Department of Corrections places these employees under the alternative formula, however, phases in the special early retirement ages over a five year period. The second proposal which also applies to individuals covered under the alternative formula provides for application of the 3% cost of living allowance commencing as early as age 55.

Legislation was introduced to increase the basic retirement formula for general employees participating in the System in an attempt to address inadequacies as set forth in the FY-84 Annual Report. A hearing was conducted on this bill before the Senate Insurance Committee, however, the proposal fell one vote short of approval. It is recommended that this or a similar proposal be pursued in future years.

Administration and Reporting

Administrative operations of the System are under the direction of the Executive Secretary assisted by a

staff of 64 full-time employees, excluding Social Security Division personnel.

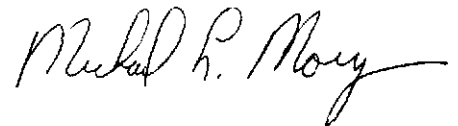
All funds of the System required for current operations are held by the Treasurer of the State of Illinois. Receipts to and disbursements from the System's trust fund are accomplished through the Comptroller of the State of Illinois according to rules and regulations issued under statutory authority by the Comptroller and the Treasurer.

The annual audit for the 1985 fiscal year was conducted under the direction of the Auditor General by the firm of Peat, Marwick, Mitchell & Co. Actuarial services for the System were performed by The Wyatt Company.

Acknowledgement

The following sections of this report present detailed financial, actuarial and statistical information pertaining to the operations of the System during the 1985 and prior fiscal years. The report has been prepared through the efforts and cooperation of the administrative staff and the System's professional consultants. Special acknowledgement is given to Robert E. Doolen, the System's Chief Fiscal Officer, who will be retiring in January of 1986 after more than 16 years of faithful service.

Respectfully submitted,



Michael L. Mory
Executive Secretary



Peat, Marwick, Mitchell & Co.
Certified Public Accountants
Peat Marwick Plaza
303 East Wacker Drive
Chicago, Illinois 60601
312-938-1000

Honorable Robert G. Cronson
Auditor General
State of Illinois

Board of Trustees
State Employees' Retirement
System of Illinois:

We have examined the balance sheets of the State Employees' Retirement System Trust Fund of Illinois as of June 30, 1985 and 1984 and the related statements of revenue and expenses, changes in reserve balances, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and the standards for financial audits contained in the U.S. General Accounting Office's Standards for Audit of Governmental Organizations, Programs, Activities, and Functions and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of the State Employees' Retirement System Trust Fund of Illinois at June 30, 1985 and 1984 and the results of its operations, changes in its reserve balances, and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examinations were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the Schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the examinations of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Peat Marwick Mitchell & Co.

October 17, 1985



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund

Balance Sheets • June 30, 1985 and 1984

Assets	1985	1984
Cash	\$ 11,216,376	\$ 9,100,232
Receivables:		
Contributions receivable:		
Participants	3,262,619	3,773,980
Employing state agencies (net of allowance for uncollectible accounts of \$11,632,320 in 1985 and \$9,798,225 in 1984) (note 3)	6,066,216	5,708,196
Other accounts receivable	<u>470,992</u>	<u>441,324</u>
	9,799,827	9,923,500
Investments - held in the Illinois State Board of Investment		
Commingled Fund at cost (Market value: 1985, \$1,729,173,899; 1984, \$1,399,637,496)	<u>1,688,252,032</u>	<u>1,564,277,185</u>
	<u>\$1,709,268,235</u>	<u>\$1,583,300,917</u>
Liabilities and Reserves		
Benefits payable	1,198,724	1,058,411
Refunds payable	265,059	522,695
Administrative expenses payable	156,036	186,295
Participant's deferred service credit accounts	<u>366,222</u>	<u>246,722</u>
	<u>1,986,041</u>	<u>2,014,123</u>
Reserves:		
Actuarially determined accrued benefit cost (note 4)	2,868,639,632	3,127,247,588
Less unfunded accrued benefit cost representing an obligation of the State of Illinois	<u>1,161,357,438</u>	<u>1,545,960,794</u>
Funded reserves	<u>1,707,282,194</u>	<u>1,581,286,794</u>
	<u>\$1,709,268,235</u>	<u>\$1,583,300,917</u>

See accompanying notes to financial statements.



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund

Statements of Revenue and Expenses

Years ended June 30, 1985 and 1984

	1985	1984
Revenue:		
Contributions:		
Participants	\$ 77,059,593	\$ 72,755,819
Employing state agencies	89,482,193	81,358,279
State Pension Fund appropriation	2,378,500	2,378,000
Supplemental state contribution (note 3)	<u>2,596,000</u>	<u>2,728,000</u>
	171,516,286	159,220,098
Net investments income	115,786,690	104,658,329
Repayment of contributions refunded	239,737	224,568
Interest earned on cash balances	780,084	729,266
Interest received from participants	531,476	461,809
Net realized gain (loss) on sale of investments	<u>(14,811,843)</u>	<u>44,782,720</u>
	<u>274,042,430</u>	<u>310,076,790</u>
Expenses:		
Benefits:		
Retirement annuities	95,965,469	86,651,697
Survivors' annuities	17,086,453	16,114,837
Disability benefits	14,164,732	13,985,426
Lump-sum death benefits	<u>5,099,824</u>	<u>4,244,111</u>
	132,316,478	120,996,071
Refunds	13,229,773	14,145,496
Administrative expenses	2,490,226	2,428,623
Transfers to reciprocating retirement systems	<u>10,553</u>	<u>—</u>
	<u>148,047,030</u>	<u>137,570,190</u>
Excess of revenue over expenses	<u>\$125,995,400</u>	<u>\$172,506,600</u>

See accompanying notes to financial statements.



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund

Statements of Changes in Reserve Balances

Years ended June 30, 1985 and 1984

	Reserve for future operations			Total funded reserves
	Participants' contributions	Interest accumulations	Other future benefits	
Balance at June 30, 1983	\$482,983,107	140,222,364	785,574,723	1,408,780,194
Add (deduct):				
Excess of revenue over expenses	56,630,071	—	115,876,529	172,506,600
Reserve transfers:				
Accumulated contributions of members who retired during the year, less con- tributions of annuitants returning to active status	(22,604,912)	—	22,604,912	—
Interest credited to members' accounts	—	25,525,757	(25,525,757)	—
Balance at June 30, 1984	\$517,008,266	165,748,121	898,530,407	1,581,286,794
Add (deduct):				
Excess of revenue over expenses	61,384,011	—	64,611,389	125,995,400
Reserve transfers:				
Accumulated contributions of members who retired during the year, less con- tributions of annuitants returning to active status	(23,569,425)	—	23,569,425	—
Interest credited to members' accounts	—	27,905,325	(27,905,325)	—
Balance at June 30, 1985	<u>\$554,822,852</u>	<u>193,653,446</u>	<u>958,805,896</u>	<u>1,707,282,194</u>

See accompanying notes to financial statements.



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund

Statements of Changes in Financial Position

Years ended June 30, 1985 and 1984

	1985	1984
Sources of working capital:		
Working capital provided by operations -- excess of revenue over expenses	\$125,995,400	\$172,506,600
Add (deduct) item not providing working capital -- net realized (gain) loss on sale of investments	<u>14,811,843</u>	<u>(44,782,720)</u>
Total sources of working capital	<u>140,807,243</u>	<u>127,723,880</u>
Uses of working capital -- investment purchases:		
Amounts transmitted by SERS	23,000,000	18,900,000
Reinvested earnings	<u>115,786,690</u>	<u>104,658,329</u>
Total uses of working capital	<u>138,786,690</u>	<u>123,558,329</u>
Net increase in working capital	<u>\$2,020,553</u>	<u>\$4,165,551</u>
Elements of net increase (decrease) in working capital:		
Cash	2,116,144	1,880,758
Receivables	(123,673)	1,939,136
Benefits payable	(140,313)	313,325
Refunds payable	257,636	192,683
Administrative expenses payable	30,259	(50,687)
Participants' deferred service credit accounts	<u>(119,500)</u>	<u>(109,664)</u>
Net increase in working capital	<u>\$ 2,020,553</u>	<u>\$ 4,165,551</u>

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund

Notes to Financial Statements • June 30, 1985 and 1984

(1) Description of System Trust Fund

The State Employees' Retirement System (System) of Illinois is a multiple-employer public employee retirement system established to provide its members with benefits at retirement, disability or death. Operation of the System Trust Fund and the direction of its policies is the responsibility of the Board of Trustees.

(a) Eligibility and Membership

Membership is automatic for most state employees who are not eligible for another state-sponsored retirement plan. All persons entering state service, except those in positions subject to membership in other state-sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal CETA program, and enrollees in the Illinois Young Adult Conservation Corps, become members of the System upon completion of six months service. Administrative Code officers appointed by the Governor may elect to become members of the System.

(b) Contributions

Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities. Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rates are 4% if coordinated with Social Security and 8% if not coordinated, except that the rate of 5½% or 9½% is used for members in certain employment categories who are eligible for benefits under alternative formulas. Participants' contributions are fully refundable, without interest, upon withdrawal from state employment. The State of Illinois is obligated by statute to contribute, through department appropriations, the funds not otherwise provided which are necessary to meet the cost of maintaining and administering the System on a funded basis in accordance with actuarial requirements.

(c) Benefits

The System is governed by Article 14 of the Illinois Pension Code and benefits under the System are defined in the Code. Employees who retire at or after age 60 (or at age 55 with at least 30 years of credited service with reduced benefits) with 8 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount based upon final average compensation and credited service. Employees with 35 years of credited service may retire at any age with full benefits.

(2) Summary of Significant Accounting Policies and Investments

(a) Basis of Accounting

The financial transactions of the System are recorded on the accrual basis of accounting and in conformity with generally accepted accounting principles. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Investment income is recognized as earned.

(b) Investments

Investments are reported at cost subject to adjustment for market declines judged to be other than temporary. Investments are managed by the Illinois State Board of Investment (ISBI) pursuant to Article 22A of the Illinois Pension Code and are held in the ISBI Commingled Fund. Such investments are valued at the cost of the System's units of participation in the ISBI Commingled Fund.

(c) Office Equipment

Expenditures for equipment are charged to administrative expense as incurred. The equipment acquisitions are also recorded in property control records at cost for accountability purposes.

(d) Actuarial Experience Review

In accordance with Illinois Revised Statutes, an actuarial experience review is to be performed at

least once every five years to determine the adequacy of actuarial assumptions regarding the mortality, retirement, disability, employment, turnover, interest and earnable compensation of the members and beneficiaries of the System. An experience review was performed as of June 30, 1985.

(e) Administrative Expenses

Expenses related to the administration of the System are paid from the retirement trust fund. The funds budgeted for this function are approved by the System's Board of Trustees.

(f) Reclassification

Certain financial statement items presented in prior years' statements have been reclassified in the current year to enhance comparability between reporting periods.

(3) System Revenue

(a) Employer Contributions

The System generates revenue based upon percentage of payrolls for employee and employer contributions. The System's funding policy provides for periodic employer contributions at rates that, expressed as percentages of annual covered payroll, are sufficient to provide resources to pay benefits when due without being increased for future generations of taxpayers. These rates are approved by the System's Board of Trustees based upon recommendations provided by the actuary. Appropriations by the state may differ from the rate adopted by the Board. In the fiscal years ended June 30, 1985 and 1984, respectively, the Board approved rates were 5.8% and 6.4% while the state appropriated rates were 5.6% and 5.4%.

The revenue recognized by the System based upon Board approved funding rates is in excess of the actual revenue received due to actual Agency remittances being based upon lower state appropriations. The difference between the two rates results in a receivable, the collectibility of which is subject to resolution by the State Court of Claims. Therefore, this uncollected amount is fully reserved for on a current basis. Additions to the allowance for uncollectible accounts amounted to \$1,834,095 and \$9,798,225 in fiscal years ended June 30, 1985, and 1984, respectively.

(b) Supplemental State Contribution

The System recognizes revenue representing supplemental state funding on a current basis. This funding is the result of reduced appropriations to the System for the year ended June 30, 1983. The amount of the reduction in that period amounted to \$11,000,000. The state has agreed to repay the under-appropriation and interest at the rate of six percent over the succeeding five fiscal years. The System does not record unpaid amounts as an asset because repayment in any given year is subject to state appropriation of funds, which is subject to numerous conditions. Consequently, repayment of principal and interest are recognized in the current year only upon receipt in the three month lapse period subsequent to the end of the fiscal period.

Payments recognized in fiscal years ended June 30, 1985 and 1984 amounted to \$2,596,000 and \$2,728,000, respectively. The balance of unpaid underappropriations is \$4,707,417 as of June 30, 1985.

(4) Accrued Benefit Cost

The calculations of accrued benefit cost (actuarial liability) were made by the consulting actuaries on the basis of the "entry age normal" cost method. The significant assumptions underlying the actuarial computations are as follows:

Rate of return on investments	8% in 1985, 7½% in 1984
Average age at retirement	65 years, except age 60 was used for those individuals employed in the uniform services
Rate of turnover without vested benefits	A high scale at younger age levels, becoming progressively lower as age advances - consistent with the System's experience
Mortality basis	1971 Group Annuity Mortality Table projected to 1986
Salary increases	6½% annual increase in 1985, 7½% annual increase in 1984
Performance of duty	
Death	5% of all deaths among active employees duty related
Disability	15% of all disabilities among active employees duty related

Included in the actuarially determined accrued benefit cost of \$2,868,639,632 is the amount of \$1,182,671,463 for retirement and survivor annuities in force.

The actuarial valuation for the year ended June 30, 1985 reflects the increase in the interest assumption from 7½% to 8% and the decrease in the level of increase of future salaries from 7½% to 6½%. The effects of these changes decreased the actuarial accrued liability by \$636,903,125 at June 30, 1985.

The current valuation also reflects the impact of Public Act 84-162. This legislation extended the alternative formula to the non-coordinated Correctional employees, changed the commencement age for the automatic increase to age 55 for employees who retire under the alternative formula, and granted a one time increase to those employees who retired under the alternative formula before the effective date of the legislation. These changes accounted for a \$65,609,601 increase in the unfunded accrued liability at June 30, 1985 which showed a total decrease of \$384,603,356 in the current year.

(5) Income Tax Status

The Internal Revenue Service has issued a favorable letter of determination on the System, thereby exempting it from Federal income taxes under provisions of the Internal Revenue Code.



STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

State Employees' Retirement System Trust Fund

Schedule of Administrative Expenses

Years ended June 30, 1985 and 1984

	1985	1984
Personal services	\$1,162,168	\$1,100,631
Retirement contributions	67,796	70,718
Social Security contributions	71,496	64,427
Group insurance	55,353	53,696
Contractual services	492,727	494,191
Travel	21,131	24,024
Printing	21,639	39,765
Commodities	13,418	21,749
Equipment	16,082	15,949
Telecommunications	28,366	23,995
Electronic Data Processing	534,390	513,522
Automotive	5,660	5,956
Total	<u>\$2,490,226</u>	<u>\$2,428,623</u>

REVENUES:

Total revenues of \$274.0 for FY 1985 was \$36.1 million below the FY 1984 level of \$310.1 million. Although net income from investments was up by \$11.1 million, the net realized loss on sale of investments of \$14.8 million in FY 1985 as compared to a net realized gain in FY 1984 of \$44.7 million resulted in a net investment income of \$101.8 million for FY 1985 as compared to the FY 1984 investment income of \$150.2 million. The \$48.4 million decrease in investment income was partially offset by increases in member contributions and contributions by the State.

Revenue Source	FY 85 (Millions)	FY 84 (Millions)	Increase/(Decrease)	
			Amount	Percentage
Member Contributions	\$ 77.8	\$ 73.4	\$ 4.4	6.0%
State Contributions	94.4	86.5	7.9	9.1%
Investment Income	<u>101.8</u>	<u>150.2</u>	<u>(48.4)</u>	<u>(32.2%)</u>
Total	\$274.0	\$310.1	(\$36.1)	(11.6%)

There were 2,672 more active members as of June 30, 1985 than on June 30, 1984. This increase of 3.9% in membership and average wage increases of 5% resulted in an increase of 9.2% in wages subject to retirement contributions. State contributions show an increase of 9.1% (\$7.9 million), consistent with the total wage increase. Member contributions were only \$4.4 million (6.0%) higher than for FY 1984 due to an ever increasing number of employees who contribute to both retirement and social security. As shown in the table below, the average rate of contributions by members in FY 1985 was 4.95% compared to 5.10% in FY 1984.

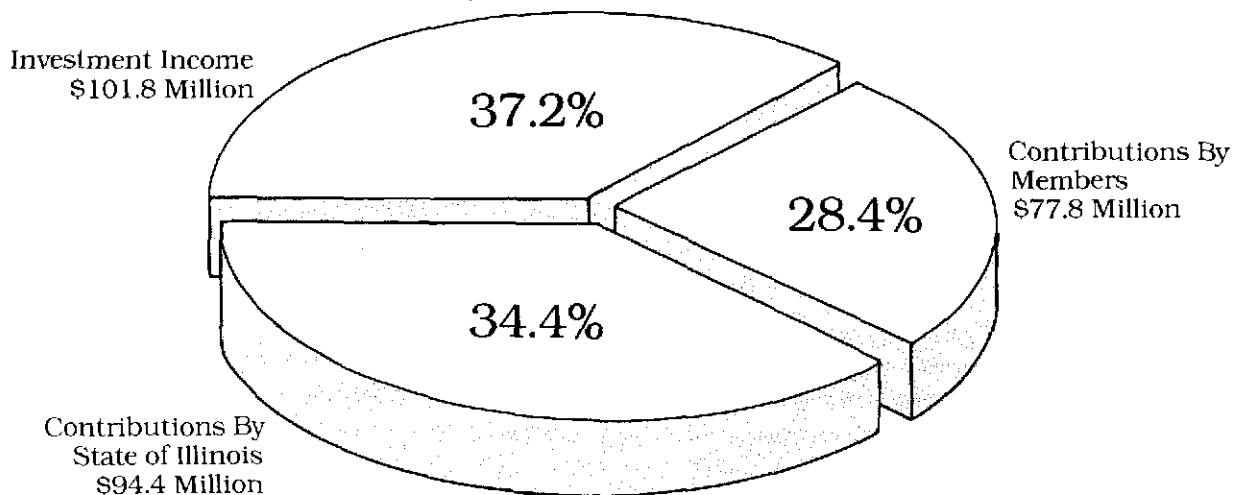
Active Membership	FY 85	FY 84	Increase/(Decrease)	
			Number/Amount	Percentage
Coordinated Members	60,346	56,945	3,401	6.0%
Noncoordinated Members	<u>11,301</u>	<u>12,030</u>	<u>(729)</u>	<u>(6.1%)</u>
Total Active Members	71,647	68,975	2,672	3.9%
Earnings Reported				
All Members (Millions)	\$1,569.5	\$1,437.5	\$132.0	9.2%
Average Rate of Contributions				
All Members	4.95%	5.10%		

REVENUES BY SOURCE

1985

TOTAL REVENUES

\$274.0 MILLION



Net investment income for 1985 of \$116,582,885, less the Investment Board's administrative expenses of \$796,195, and the net realized loss on sale of investments amounting to \$14,811,843, resulted in net revenue from investments of \$100,974,847. Transfers of funds to the Illinois State Board of Investment amounted to \$27,000,000 and transfers from the Board of \$4,000,000 resulted in a net transfer for investments of \$23,000,000. Balance of investments at cost increased by \$100,974,847 plus \$23,000,000, or \$123,974,847, from June 30, 1984 thru June 30, 1985. The following table shows a comparison of investment operations for FY 1985 and FY 1984.

	1985	1984	Increase/(Decrease) Amount	Percentage
Balance at beginning				
of year, at cost	\$1,564,277,185	\$1,395,936,136	\$168,341,049	12.1%
Cash remitted for investment (net)	23,000,000	18,900,000	4,100,000	21.7%
Investment income:				
Commingled Fund income	116,582,885	105,321,675	11,261,210	10.7%
Less expenses	(796,195)	(663,346)	132,849	20.0%
Distributed net realized gain/				
(Loss) on sale of investments	(14,811,843)	44,782,720	(59,594,563)	(133.1%)
Net investment income	<u>100,974,847</u>	<u>149,441,049</u>	<u>(48,466,202)</u>	<u>(32.4%)</u>
Balance at end				
of year, at cost	<u>\$1,688,252,032</u>	<u>\$1,564,277,185</u>	<u>\$(123,974,847)</u>	7.9%
Market value	<u>\$1,729,173,899</u>	<u>\$1,399,637,496</u>	<u>\$329,536,403</u>	23.5%

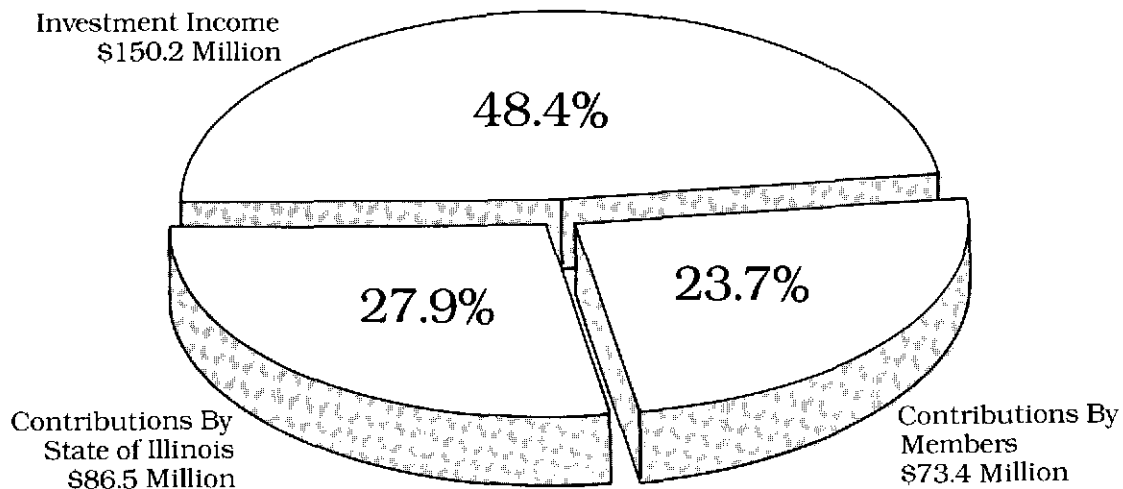
Interest on the average balance in the System's operating fund for FY 1985 was \$780,084, compared to \$729,266 during FY 1984 due to higher operating revenues received from contributions by members and the State of Illinois.

REVENUES BY SOURCE

1984

TOTAL REVENUES

\$310.1 MILLION



Revenues were used to pay current expenses or credited to the appropriate reserve accounts as shown below:

Distribution of Revenues - FY 85	Contribution by Members	Contributions by State	Investment Income	Totals
Reserve - Future Operations	\$ 0.5	\$ —	\$ 64.1	\$ 64.6
Reserve - Member Contributions	61.4			61.4
Benefit Payments	2.7	91.9	37.7	132.3
Refunds	13.2			13.2
Administrative Expense		2.5		2.5
TOTAL	<u>\$77.8</u>	<u>\$94.4</u>	<u>\$101.8</u>	<u>\$274.0</u>

EXPENSES:

The number of members receiving retirement annuities on June 30, 1985 was 4.0% above the June 30, 1984 level reflecting the normal pattern of increase during the past 10 years, however, the cost of these annuities increased by 10.7% over the FY 1984 level. Higher salary levels for current retirees and post retirement increases granted each January 1 result in costs rising at a more rapid pace than the number of annuitants. Survivor annuities increased at a near normal rate of 3.5% in number with a 6.3% increase in dollar costs. Continued review of disability recipient eligibility helped reduce the number of recurring benefit payments for disability by 3.6%, while rising salary rates increased the dollar amount of payments by 0.7%.

	FY 85 (Millions)	FY 84 (Millions)	Increase/(Decrease) Amount	Percentage
Retirement Benefits	\$ 96.0	\$ 86.7	\$ 9.3	10.7%
Survivors Benefits	17.1	16.1	1.0	6.3%
Disability Benefits	14.1	14.0	0.1	0.7%
Lump Sum Death Benefits	5.1	4.2	0.9	21.4%
Contribution Refunds	13.2	14.2	(1.0)	(0.7)%
Administrative Expenses	2.5	2.4	0.1	4.0%
TOTAL EXPENSES	<u>\$148.0</u>	<u>\$137.6</u>	<u>\$10.4</u>	<u>7.6%</u>

NUMBER OF RECURRING BENEFIT PAYMENTS:

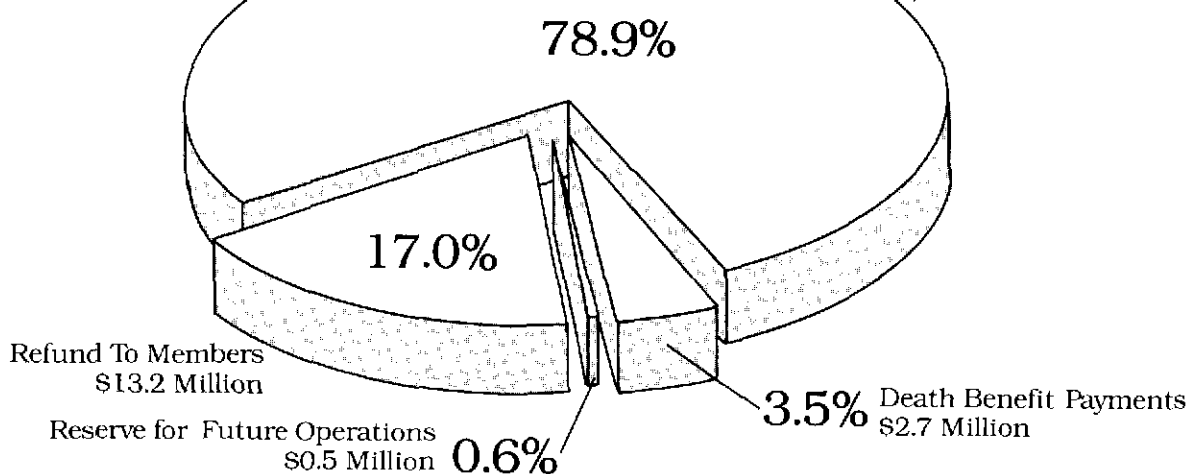
	FY Ended June 30, 1984	New Claims Processed During FY 85	Benefits Ceased During FY 85	FY Ended June 30, 1985	Increase/(Decrease) Amount	Percentage
Retirement	20,157	1,639	827	20,969	812	4.0%
Survivors	7,371	568	313	7,626	255	3.5%
Disability	<u>1,799</u>	<u>2,182</u>	<u>2,247</u>	<u>1,734</u>	<u>(65)</u>	<u>(3.6%)</u>
TOTALS	<u>29,327</u>	<u>4,389</u>	<u>3,387</u>	<u>30,329</u>	<u>1,002</u>	<u>3.4%</u>

Lump sum death benefits are primarily refunds of member contributions and will vary from year to year. Refunds to members have shown a marked decline from 10,252 in FY 1983 and 7,664 in FY 1984 to 5,638 in FY 1985. This drop in the number of refunds is due primarily to the 6 month qualifying period required of new employees since January, 1984. The short term employees who never become members and, therefore, no refund is required upon termination, do not greatly affect the dollar amount of refunds which was down only \$1.0 million from the 1984 level to \$13.2 million in FY 1985.

REVENUES FY 1985 – HOW THEY WERE USED

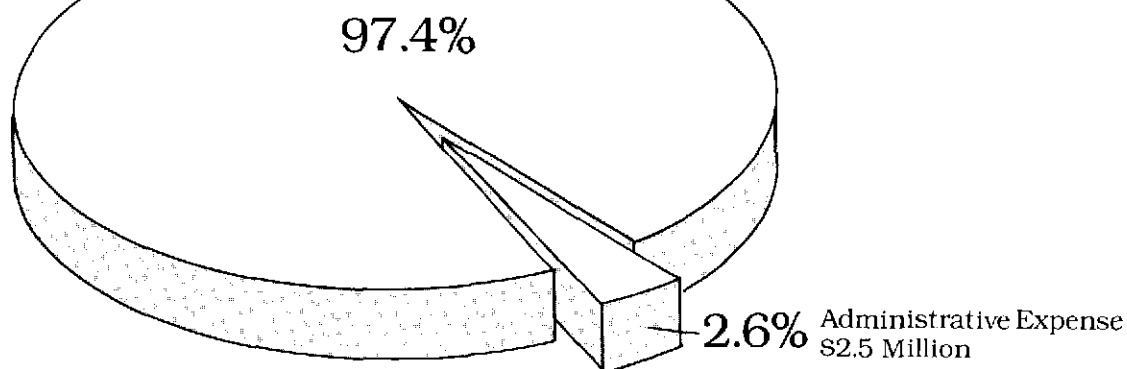
MEMBER CONTRIBUTIONS \$77.8 MILLION

Reserve for Member Contributions
\$61.4 Million



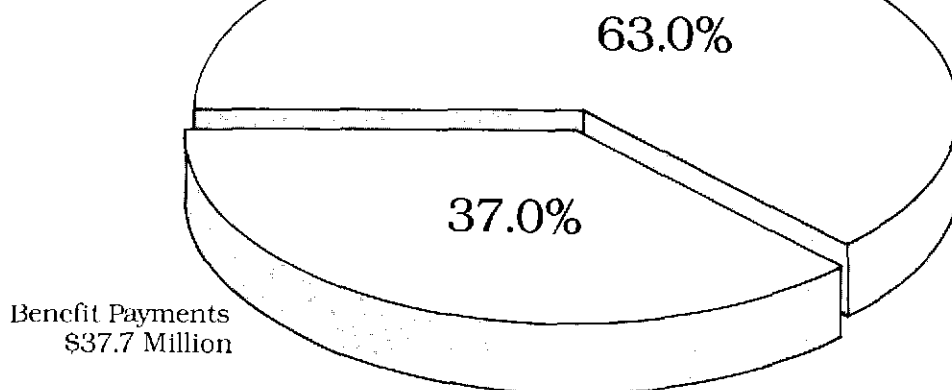
CONTRIBUTIONS BY STATE OF ILLINOIS \$94.4 MILLION

Benefit Payments
\$91.9 Million



INVESTMENT INCOME \$101.8 MILLION

Reserve For Future Operations
\$64.1 Million



Administrative expenses increased only 4.0% from FY 1984 to \$2.5 million in FY 1985. Normal increases in costs for personal services and data processing were partially offset by decreases in printing and commodities due to member booklets, file folders and other miscellaneous items purchased in FY 1984 which were not required in FY 1985.

RESERVES:

As of June 30, 1985, the funds available for payment of current and future benefits were \$1,707.2 million as shown in the following schedule:

Assets	FY-85 (Millions)	FY-84 (Millions)	Increase (Decrease)
Cash	\$ 11.2	\$ 9.1	\$ 2.1
Receivables (less payables)	7.8	7.9	(0.1)
Investments	<u>1,688.2</u>	<u>1,564.2</u>	<u>124.0</u>
NET ASSETS	<u>\$1,707.2</u>	<u>\$1,581.2</u>	<u>\$126.0</u>

Total revenues for FY 1985 of \$274.0 million less expenditures of \$148.0 million resulted in a net increase to reserves of \$126.0 million.

Reserves	FY-85 (Millions)	FY-84 (Millions)	Net Increase
Member Contributions	\$ 554.8	\$ 517.0	\$ 37.8
Future Operations	<u>1,152.4</u>	<u>1,064.2</u>	<u>88.2</u>
TOTAL RESERVES	<u>\$1,707.2</u>	<u>\$1,581.2</u>	<u>\$126.0</u>

Member contributions transferred to the Reserve for Future Operations due to retirement or death of active members during the year amounted to \$23.5 million.

SOCIAL SECURITY:

On September 15, 1953, the State of Illinois and the Federal Government signed an agreement making social security coverage available to public employees in Illinois. The System, as State Administrator, collects and transmits social security contributions to the U.S. Department of Health and Human Services for approximately 1,500 towns, villages and other political entities. Members of two retirement systems in the state, the Illinois Municipal Retirement Fund (IMRF) and the State Employees' Retirement System (SERS), are also covered by social security. During fiscal year 1985 contributions collected and transmitted for the political entities amounted to \$32.5 million for approximately 25,000 employees, and for the SERS, \$174.6 million for 75,140 members. Since semi-monthly deposits of FICA contributions are now required, the IMRF is transmitting directly to the Federal Government. Auditing of FICA contributions of political entities reporting through IMRF is performed by this office.

The Social Security Division has a staff of five full-time employees. Data processing and accounting services are performed by other divisions of the System on a contractual basis. Expenses are appropriated by the General Assembly and subsequently recovered from the reporting entities on a pro-rata basis for deposit in the General Revenue Fund.

The contribution rate in 1985 was 7.05% for the employee and 7.05% for the employer on maximum wages of \$39,600. Collections and transmittals are administered through a State Trust Fund in custody of the Treasurer of the State of Illinois.

THE *Wyatt* COMPANY

ACTUARIES AND CONSULTANTS

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ACTUARIAL CERTIFICATION

We have completed an actuarial valuation of the assets and liabilities of the State Employees' Retirement System of Illinois as of June 30, 1985. This valuation was made using actuarial assumptions which were changed from the prior year.

Pursuant to the law establishing the system, we reviewed the experience under the system for the last five years as it relates to the actuarial assumptions used in the valuation. Based on the results of this study, we proposed and the Board adopted a revised set of assumptions. This new set of assumptions includes more optimistic economic assumptions; the investment return assumption was raised to 8 percent per annum from 7-1/2 percent, and the salary increase assumption was lowered to 6-1/2 percent per annum from 7-1/2 percent. These changes reflect both actual experience under the system and trends which we expect to continue. Certain other changes were made to the demographic assumptions (turnover and disability rates) to better reflect experience.

For purposes of determining contribution rates, assets have been valued at Cost as reported by the Illinois State Board of Investment. The liabilities have been valued based on employee data supplied by the staff of the System and based on the revised actuarial assumptions.

In our opinion, the following schedule of valuation results fairly presents the financial condition of the State Employees' Retirement System of Illinois as of June 30, 1985 and the contribution rate complies with the applicable law in force as of the valuation date.

THE WYATT COMPANY

By S. Lynn Hill
S. Lynn Hill
Actuarial Assistant

By Lloyd L. Nordstrom
Lloyd L. Nordstrom
Fellow of the Society of Actuaries

By Robert L. Barnes
Robert L. Barnes
Fellow of the Society of Actuaries

Chicago, Illinois

ACTUARIAL COST METHOD AND SUMMARY OF MAJOR ACTUARIAL ASSUMPTIONS

The System utilizes the entry age normal cost method. Under this method, the projected pensions at retirement age are first determined and the values thereof at the individual member's entry age or hire age are determined. The values so determined are divided by the value at entry age of all future compensation payable to the member to determine the normal cost as a level percentage of covered pay. The normal cost for a particular year is that percentage of covered compensation for the year.

The actual liability at any point in time is the value of the projected pensions at that time, less the value of future normal costs.

For ancillary benefits for active members, in particular disability benefits, death and survivor benefits, termination benefits and the post-retirement increments, the same procedure as outlined above is followed except that the entry age is the age at the later of hire date or June 30, 1980.

As stated by the actuary in their certification letter, the actuarial valuation prepared as of June 30, 1985, reflects a material change in assumptions. A description of the actuarial assumptions utilized for FY-85 and FY-84 follows:

Mortality: 1986 Projected Experience Table, a table based on experience underlying the 1971 Group Annuity Mortality Table, without margins, with a projection for mortality improvements to 1986. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

Interest: ~~8%~~ 7½% per annum, compounded annually.

Termination: Illustrative rates follow. It is assumed that terminated employees will not be rehired.

Age	Rate		Rate	
	Males	Females	Males	Females
20	.605	.397	.374	
25	.178	.164	.249	
30	.112	.116	.174	
35	.077	.092	.124	
40	.064	.076	.073	
45	.054	.061	.047	
50	.044	.048	.020	
55	.000	.000	—	

Salary Increases: ~~6½%~~ 7½% per annum, compounded annually.

Retirement Rates: Retirement was assumed to occur at age 65 except for "uniform services" which were assumed to retire at age 60.

Assets: Assets available for benefits are valued at cost.

Expenses: As estimated and advised by SERS staff, based on current expenses with an allowance for expected increases.

Marital Status: 85% of employees are assumed to be married.

Spouse's Age: The spouses of eligible employees were assumed to be three years younger than the employees.

In addition to the above, other assumptions used included disability incidence, recovery from disability, mortality of disabled lives, remarriage rates, ages and numbers of children and Social Security benefit levels.

VALUATION RESULTS

Actuarial Liability (Reserves)	<u>FY-85</u>	<u>FY-84</u>
For Annuitants:		
For Benefit Recipients:		
Retirement Annuities	\$ 978,074,174	\$ 939,228,187
Survivor Annuities	139,250,458	137,894,263
Disability Annuities	59,601,343	78,584,198
Deferred:		
Retirement Annuities	1,479,840	1,241,794
Survivor Annuities	4,265,648	4,949,158
Total	<u>\$1,182,671,463</u>	<u>\$1,161,897,600</u>
For Inactive Members:		
Eligible for Deferred Vested Pension Benefits	51,337,300	53,941,666
Eligible for Return of Contributions Only	7,046,502	7,114,083
Total	<u>\$ 58,383,802</u>	<u>\$ 61,055,749</u>
For Active Members:	<u>\$1,627,584,367</u>	<u>\$1,904,294,239</u>
Total	<u>\$2,868,639,632</u>	<u>\$3,127,247,588</u>
Assets (Cost Value)	<u>\$1,707,282,194</u>	<u>\$1,581,286,794</u>
Unfunded Actuarial Liability	<u>\$1,161,357,438</u>	<u>\$1,545,960,794</u>

SHORT-TERM SOLVENCY TEST

A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets (cash and investments) are compared with: 1) active member contributions on deposit; 2) the liabilities for future benefits to present retired lives; 3) the liabilities for service already rendered by active members. In a system that has been following level percent of payroll financing, the liabilities for active member contributions on deposit (liability 1) and the liabilities for future benefits to present retired lives (liability 2) should generally be covered by present assets. In addition, the liabilities for service already rendered by active members (liability 3) should be partially covered by the remainder of present assets. If the system continues using level cost financing, the funded portion of liability 3 will increase over time, although it is very rare for a system to have its liability 3 fully funded.

The State of Illinois, however, has funded the System based on benefit payout, a level which increases over time reflecting a larger work force and higher salary levels. Consequently, it can be expected that none of liability 3 has been funded to date. It should also be noted that the improvement reflected in FY-85 results primarily from the change in actuarial assumptions previously described.

Computed Actuarial Values

(in thousands of dollars)

Fiscal Year	Member Contributions (1)	Current Retirants and Beneficiaries (2)	Active and Inactive Members, Employer Financed Portion (3)	Net Assets Available For Benefits	Percentage of Actuarial Values Covered by Net Assets Available		
					(1)	(2)	(3)
1976	\$251,773	\$ 400,427	\$ 652,255	\$ 581,531	100	82.4	0
1977	272,658	511,579	645,130	650,282	100	73.8	0
1978	316,877	552,317	672,962	730,016	100	74.8	0
1979	347,173	598,170	684,422	799,803	100	75.7	0
1980	378,468	791,289	764,297	934,864	100	70.3	0
1981	413,773	819,272	960,085	1,081,805	100	81.5	0
1982	448,908	914,281	1,144,618	1,200,142	100	82.2	0
1983	482,983	1,049,972	1,270,744	1,408,780	100	88.2	0
1984	517,008	1,161,897	1,448,342	1,581,287	100	91.6	0
1985	554,823	1,182,671	1,131,145	1,707,282	100	97.4	0

ANALYSIS OF FUNDING

In an inflationary economy, the value of dollars decreases. This environment results in employees' pay and retirement benefits increasing in dollar amounts resulting in unfunded accrued liabilities which increase in dollar amounts, all at a time when the actual substance of these items may be decreasing. Looking at just the dollar amounts of unfunded accrued liabilities can be misleading. The ratio of the unfunded accrued liabilities to active employee payroll provides an index which clarifies understanding. The smaller the ratio of unfunded liabilities to active member payroll, the stronger the system. Observation of this relative index over a period of years will give an indication of whether the system is becoming financially stronger or weaker. It should be noted that the improvement reflected in the following schedule for FY-85 results primarily from a change in actuarial assumptions previously described.

(in thousands of dollars)						
Fiscal Year	Total Actuarial Liability	Net Assets	Net Assets as a % of Actuarial Liability	Total Unfunded Actuarial Liability	Member Payroll	Unfunded Actuarial Liability as a % Member Payroll
1976	\$1,304,455	\$ 581,531	44.6%	\$ 722,924	\$ 864,154	84%
1977	1,429,367	650,282	45.5%	779,084	884,493	88%
1978	1,542,156	730,016	47.3%	812,140	925,094	88%
1979	1,629,766	799,803	49.1%	829,962	1,069,886	78%
1980	1,934,054	934,864	48.3%	999,190	1,137,668	88%
1981	2,193,130	1,081,805	49.3%	1,111,325	1,253,016	89%
1982	2,507,807	1,200,142	47.9%	1,307,665	1,334,262	98%
1983	2,803,699	1,408,780	50.2%	1,394,919	1,378,735	101%
1984	3,127,248	1,581,287	50.6%	1,545,961	1,437,546	108%
1985	2,868,640	1,707,282	59.5%	1,161,357	1,569,532	74%

RECONCILIATION OF UNFUNDED ACTUARIAL LIABILITY

	<u>FY-85</u>	<u>FY-84</u>
Unfunded Liability Beginning of FY	\$1,545,960,794	\$1,394,918,983
Contributions Due		
Interest on the Unfunded Liability	115,947,060	104,618,924
Total Normal Cost	161,628,041	153,455,741
Interest on Normal Cost	12,122,103	11,509,181
Total Due	\$ 289,697,204	\$ 269,583,846
Contributions Paid		
Participants	\$ 77,059,593	\$ 72,755,819
Employing State Agencies	92,078,193	84,086,279
State Pension Fund	2,378,500	2,378,000
Interest on Contributions	6,072,218	5,970,754
Total Paid	\$177,588,504	\$165,190,852
Increase (Revenue) in the Unfunded Liability	112,108,700	104,392,994
Actuarial (Gains) Losses		
From Investment Return		
(Greater) Lesser Than 7½%	16,840,742	(44,386,306)
From Salary Increases		
(Greater) Lesser Than 7½%	(3,925,773)	\$28,564,414
From Other Sources	61,666,499	(14,047,838)
Total Actuarial (Gains) Losses	\$ 74,581,468	(\$ 29,869,730)
(Decrease) Due to New Actuarial Assumptions	(636,903,125)	-
Plan Amendments	65,609,601	76,518,547
Total Increase (Decrease) in Actuarial Liability	(384,603,356)	151,041,811
Unfunded Liability End of FY	<u>\$1,161,357,438</u>	<u>\$1,545,960,794</u>

INVESTMENT REPORT

By state law the System's investment function is managed by the Illinois State Board of Investment. The Board was created in 1969 to provide a means of centralizing the investment management function for public employee pension funds and retirement systems operating in the state. At the end of the fiscal year, in addition to the assets of the State Employees' Retirement System, the Board also managed the investment function for the Judges and General Assembly Retirement Systems. As of June 30, 1985, total assets under management valued at market amounted to \$1.863 billion. Of that total, \$1.729 billion or 92% represented assets of the State Employees' Retirement System.

Management Approach

During the past ten years, all equity and fixed income investments have been managed internally. While this approach produced generally acceptable returns and lower management expenses, the volatility of the fund, particularly the equity side, was a concern due primarily to a lesser degree of fund diversification. Faced with a decision whether to continue managing equities internally and in a single investment style or to incorporate a more diverse method of management, the Board decided to retain the services of an investment consultant, Stratford Advisory Group. Following an intense review of the equity portfolio management, the consultants submitted their report which contained a recommendation to change the structure of the equity portfolio embodying a two-style investment approach, implemented by both external and internal management. The styles, as finally determined by the Board, are best characterized as "value" and "growth" oriented. After several months of further deliberation, the Board decided to proceed and adopt the recommendation with certain modifications. The decision was to divide the equity portfolio into two segments of value and growth with approximately 65% of the portfolio dedicated to value style investment and 35% to the growth style. In addition, it was further decided to divide the management between a number of external managers and two internal managers.

Implementation of the new policy was a cooperative effort between the consultant, director and the entire Board and involved an extensive search for both external and internal managers who could carry out the policy as formulated. External managers retained for each investment style are as follows:

Value Oriented Managers

Disciplined Investment Advisors
Fidelity Management Trust Co.
Lazard Freres Asset Management
Newbold Assest
TCW Value Added Fund
Trinity Investment Management

Growth Oriented Managers

Cooke & Bieler
Lincoln Capital Management
Rothschild Asset Management

The Board has also employed Mr. Bruce Poznak to manage the internal value portfolio and Mr. John Nelson to manage the internal growth portfolio. Both individuals have extensive educational and practical backgrounds in their respective disciplines.

The Board believes that the new approach to equity portfolio management will increase portfolio diversification and decrease volatility of the fund thus creating an atmosphere which may favorably impact total investment performance.

On the fixed income portion of the portfolio, the changes in policy, while less dramatic, were nonetheless important. The Board maintained its conservative approach to fixed income management, with the objective of maximizing return consistent with a lower level of risk. Based on an analysis of the bond market and fundamental security analysis, it was determined to set a goal of reducing exposure in the long-term market, while continuing to emphasize quality. This shift was gradually implemented during the fiscal year and resulted in the average maturity of the portfolio being reduced from 14.8 years as of June 30, 1984, to 8.8 years at June 30, 1985. On the quality side, the "AAA" component was increased by 6.4%. Making basic changes such as these over a market cycle should enable the portfolio manager to better control risk and add value to the portfolio.

Results

Over the past three and five-year periods, the Fund has produced an annualized rate of return of 18.5% and 11.6% respectively. The total rate of return for the Fund for the fiscal year 1985 was 22%. This is the third highest annual rate of return in the history of the Fund and compares very favorably with the return of (5.2)% in the prior year. However, according to the Merrill Lynch Evaluation Service, the Fund placed in the third quartile of performance. It is the Board's long-term goal to place in the upper quartiles and with the portfolio restructuring now in place, it is the opinion of the Board that such a goal is more obtainable.

The fixed income segment of the portfolio produced a very strong 34.9% return in the fiscal period. In

analyzing this figure in comparison to the standard indices, the Fund's performance was an exceptional one in that the portfolio was structured closer to the Shearson Lehman Gov't./Corp. Index, yet outperformed it by 6.2%. The fixed income return was the major contributor to the overall return of the Fund.

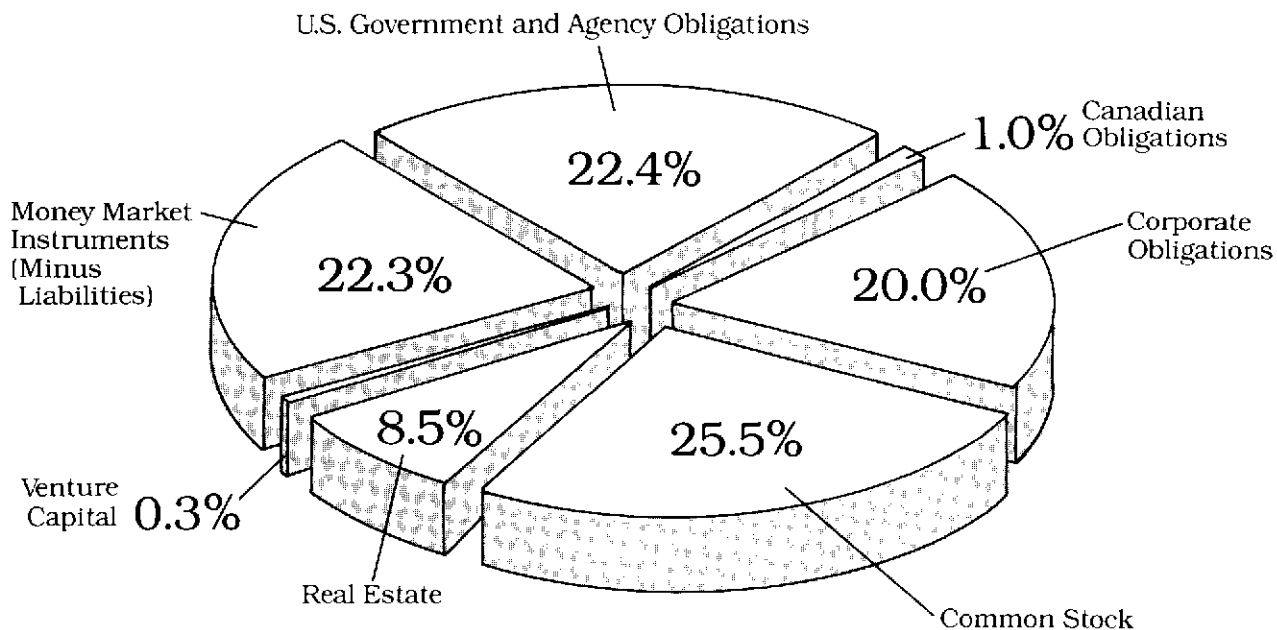
While the equity portion of the portfolio produced a positive total return of 15.8%, it was below the average of the comparison indices. The restructuring of the equity portfolio during the fiscal year curtailed, to some extent, active management and in effect, placed the equity portfolio in a more passive mode for the latter part of the period.

For additional information regarding the System's investment function, please refer to the Annual Report of the Illinois State Board of Investment, June 30, 1985. A copy of the report can be obtained from the Board at 180 North LaSalle Street, Suite 2015, Chicago, IL 60601.

INVESTMENT PORTFOLIO SUMMARY

Investments, at market value	\$	%
U.S. Government and Agency Obligations	417,052,283	22.4
Canadian Obligations	17,650,000	1.0
Corporate Obligations	372,990,775	20.0
Common Stock	475,005,198	25.5
Real Estate	157,674,209	8.5
Venture Capital	6,198,491	0.3
Money Market Instruments	417,766,751	22.3
	<u>1,864,337,707</u>	<u>100.10</u>
Other Assets, Less Liabilities	(1,756,688)	(0.10)
Net Assets, at market value	<u>*1,862,581,019</u>	<u>100.00</u>
Net Assets, at cost	<u>*1,818,400,719</u>	

*Represents total assets under management of the Illinois State Board of Investment. Assets of the State Employees' Retirement System were \$1,729,173,899 at market and \$1,688,252,032 at cost as of June 30, 1985.



ANALYSIS OF INVESTMENT PERFORMANCE

	1985	1984	1983	1982	1981
Total Return* - Past 3 years	18.5%				
Total Return* - Past 5 years					
Total Return* - year by year	22.0%	(5.2)%	44.1%	4.8%	(0.1)%
Actuarial Assumed Rate of Return					
Average Net Income Yield*	7.3	7.3	7.7	10.5	10.3

Comparative rates of return on fixed income securities

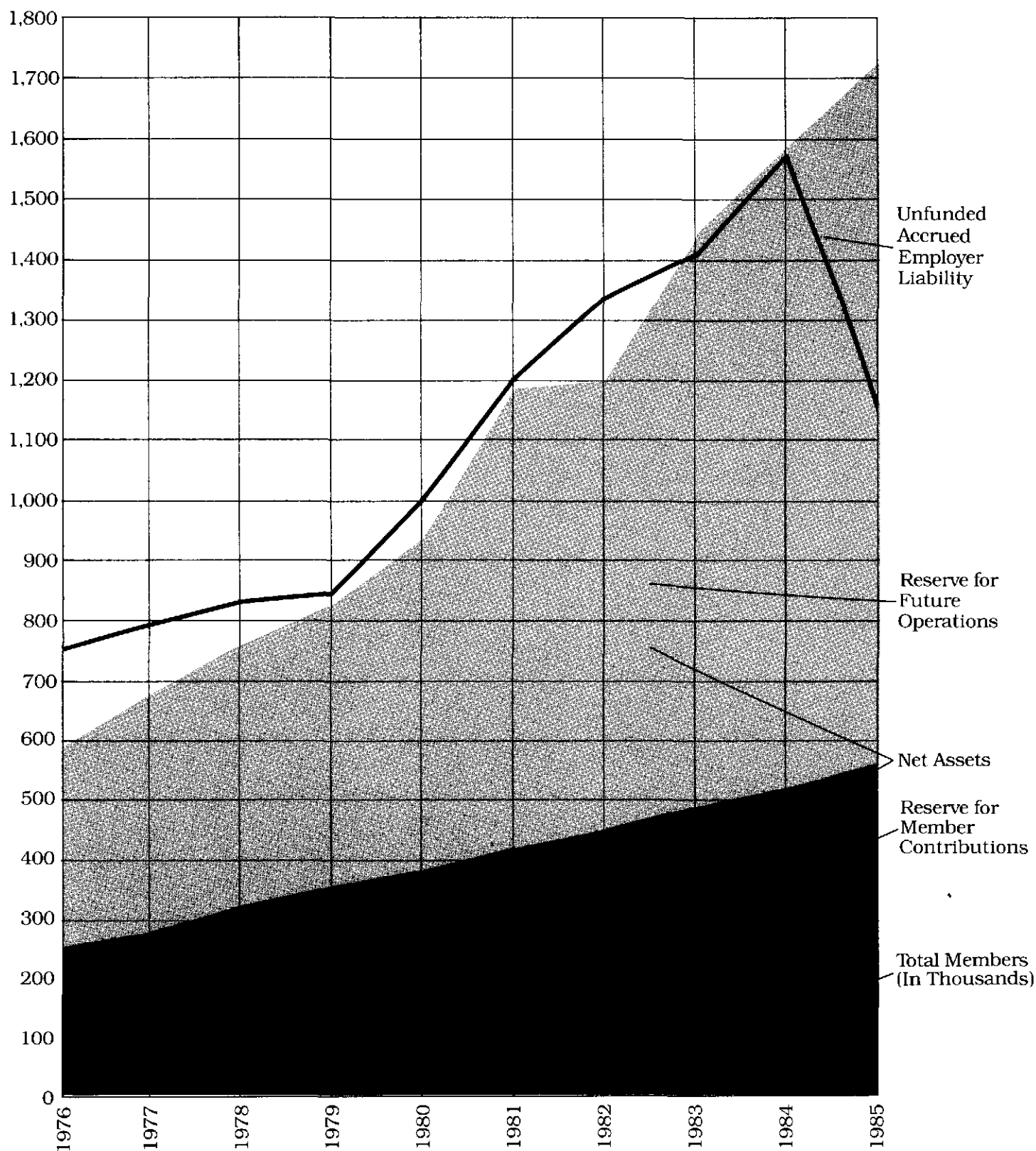
Total fixed income-ISBI	34.9	(0.7)	37.2	11.4	(8.6)
Comparison indices:					
Lehman Bros. Kuhn Loeb	28.7	1.8	29.1	13.3	(4.1)
Salomon Bros.	41.9	(6.2)	42.4	8.7	(12.9)
Merrill Lynch Median Retirement Fund	29.3	1.2	28.7	11.9	(5.8)

Comparative rates of return on equities

Total equities-ISBI	15.8	(12.9)	62.0	(8.4)	19.0
Comparison indices:					
S & P 500	30.7	(4.7)	61.6	(11.5)	20.5
Dow Jones	22.6	(3.0)	58.3	(11.3)	17.8
Merrill Lynch Median Retirement Fund	31.0	(8.7)	63.4	(13.3)	23.9

*Total return is the combined effect of income earned and market appreciation (depreciation). Average net income yield is the income earned for the year divided by the average market value of assets employed.

A comparison of total members, net assets and unfunded accrued liabilities for the past ten years.



BALANCE SHEET ASSETS

FY Ended June 30	Cash	Receivables	Investments At Cost	Investment Adjustment*	Total
1976	\$ 3,764,437	5,510,363	573,602,103		582,876,903
1977	3,415,765	6,935,185	641,637,642		651,988,592
1978	3,050,460	7,881,156	721,232,408		732,164,024
1979	2,344,567	10,233,683	832,097,108	*(42,998,251)	801,677,107
1980	2,902,092	12,467,758	966,813,414	*(45,458,776)	936,724,488
1981	6,201,164	8,310,125	1,119,702,537	*(50,493,338)	1,083,720,488
1982	7,494,162	6,390,869	1,236,672,447	*(48,013,214)	1,202,544,264
1983	7,219,474	7,984,364	1,395,936,136	-0-	1,411,139,974
1984	9,100,232	9,923,500	1,564,277,185		1,583,300,917
1985	11,216,376	9,799,827	1,688,252,032		1,709,268,235

*Allowance for accumulated net realized loss distributed by the Illinois State Board of Investment. Since 1982 net realized gains and losses have been distributed annually.

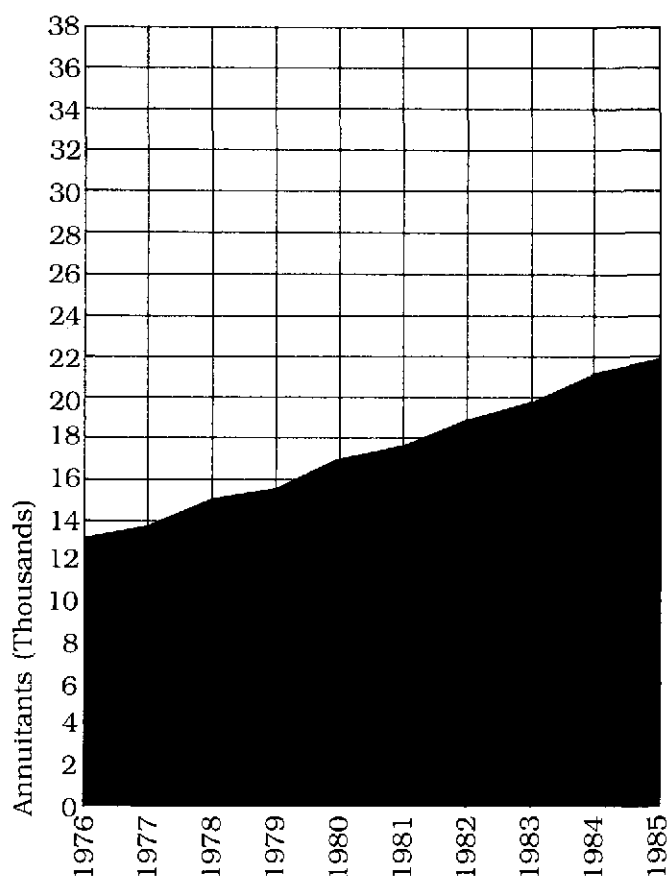
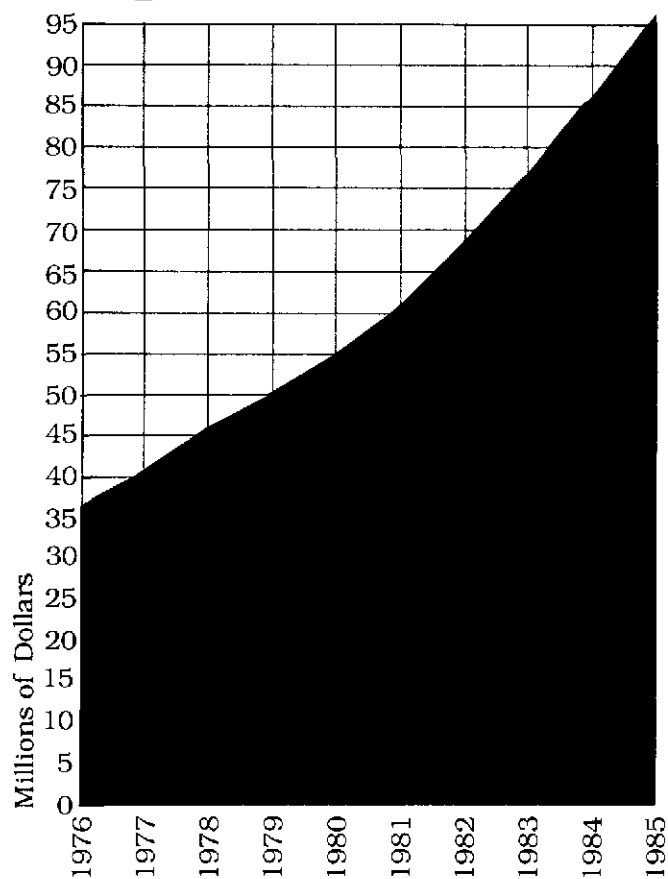
BALANCE SHEET LIABILITIES

FY Ended June 30	Accounts Payable	Reserve For Member Contributions	Reserve For Future Operations	Total
1976	\$1,345,624	251,772,923	329,758,356	582,876,903
1977	1,706,369	272,657,843	377,624,380	651,988,592
1978	2,147,812	316,877,147	413,139,065	732,164,024
1979	1,873,826	347,173,321	452,629,960	801,677,107
1980	1,860,828	378,467,810	556,395,850	936,724,488
1981	1,915,436	413,772,565	668,032,467	1,083,720,488
1982	2,402,469	448,908,264	751,233,531	1,202,544,264
1983	2,359,780	482,983,107	925,797,087	1,411,139,974
1984	2,014,123	517,008,266	1,064,278,528	1,583,300,917
1985	1,986,041	554,822,852	1,152,459,342	1,709,268,235

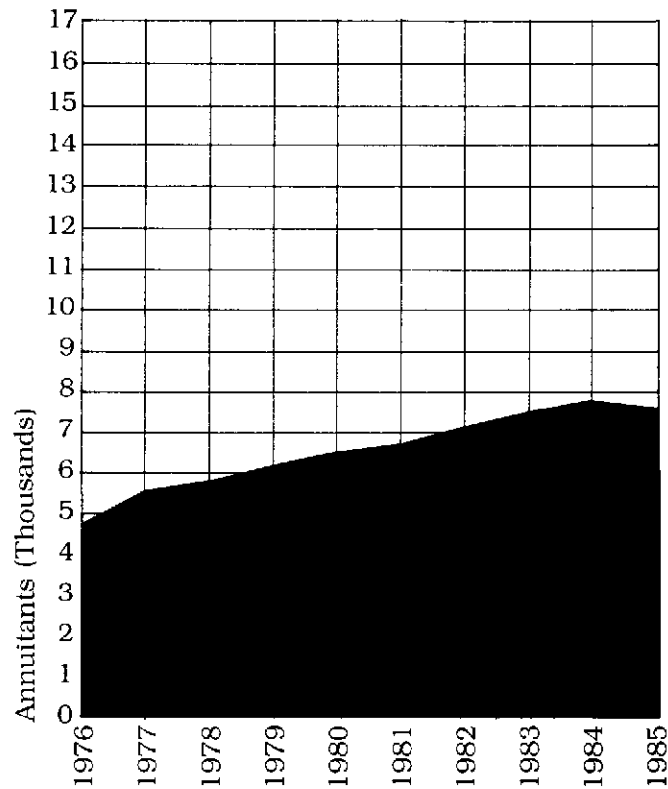
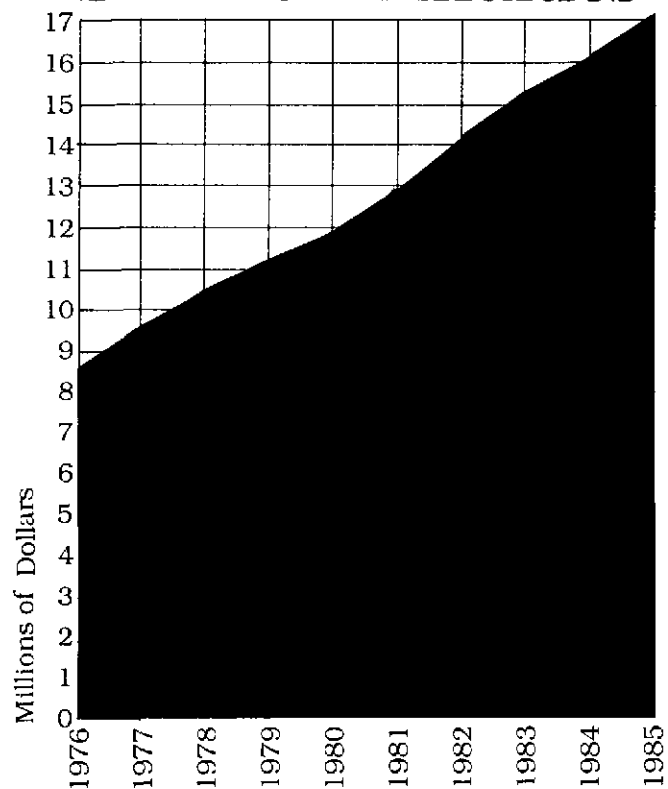
REVENUES BY SOURCE

FY Ended June 30	Member Contributions	State Contributions	Investment Income	Total
1976	\$47,533,641	58,071,332	32,051,811	137,656,784
1977	48,223,281	59,797,781	38,073,046	146,094,108
1978	51,025,294	69,384,874	44,025,044	164,435,212
1979	56,328,543	84,762,923	61,496,348	202,587,814
1980	59,448,493	94,056,122	79,438,744	232,943,359
1981	64,573,084	96,918,451	93,957,329	255,448,864
1982	69,300,949	61,500,375	101,697,502	232,498,826
1983	72,371,246	71,846,403	192,573,257	336,790,906
1984	73,442,196	86,464,279	150,170,315	310,076,790
1985	77,830,806	94,456,693	101,754,931	274,042,430

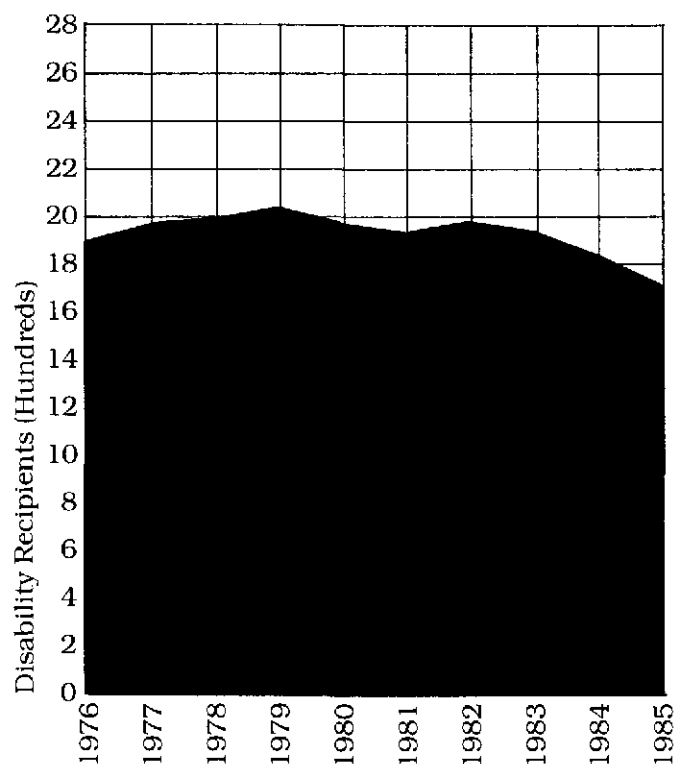
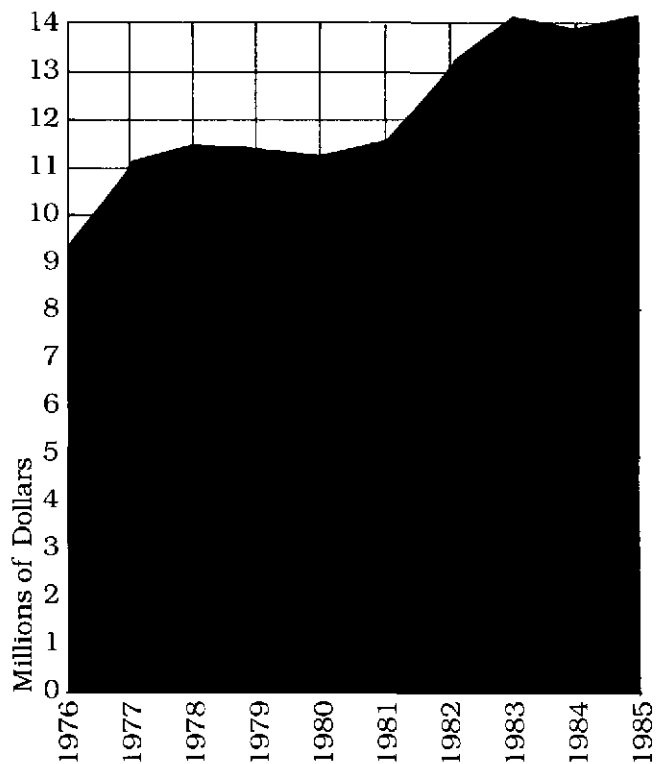
Age Retirement Annuities



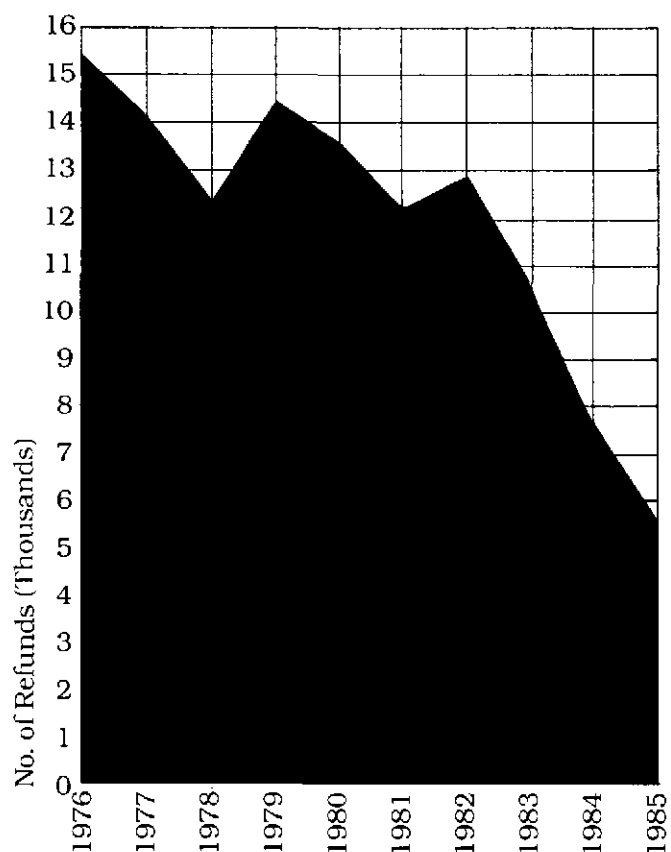
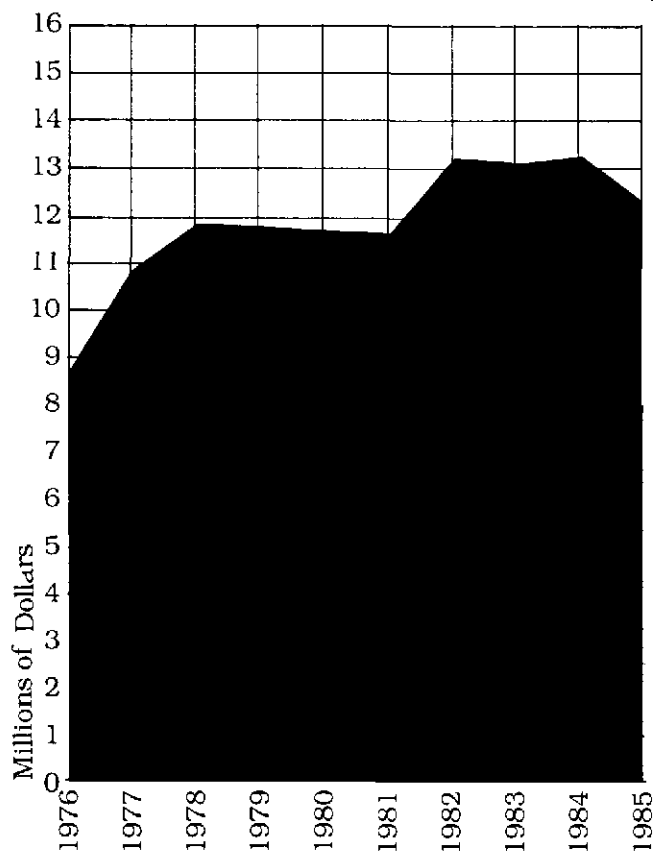
Survivor Annuities



Disability Benefits



Termination Refunds



EXPENSES BY TYPE

FY Ended June 30	Benefits	Contribution Refunds	Administrative Expenses	Other Expenses*	Total
1976	\$ 57,441,849	9,297,688	1,250,217		67,989,754
1977	64,795,216	11,416,369	1,131,579		77,343,164
1978	70,985,910	12,438,437	1,276,876		84,701,223
1979	76,000,765	12,344,851	1,456,878		89,802,494
1980	81,342,048	12,328,329	1,752,078	2,460,525	97,882,980
1981	89,147,299	12,352,136	1,973,475	5,034,562	108,507,472
1982	100,453,675	13,942,805	2,245,727	(2,480,124)	114,162,083
1983	111,852,846	14,009,169	2,290,492	-0-	128,152,507
1984	120,996,071	14,145,496	2,428,623	-0-	137,570,190
1985	132,316,478	13,240,326	2,490,226		148,047,030

*Net realized loss or (gain) on investments undistributed by the Illinois State Board of Investment. Accumulated net losses from 1970 through 1979 amounted to \$42,998,251. Since 1982 realized losses or gains have been distributed annually.

BENEFIT EXPENSES BY TYPE

FY Ended June 30	Retirement Annuities	Survivors Annuities	Disability Benefits	Lump Sum Death Benefits	Total
1976	\$37,171,787	8,600,668	9,384,124	2,285,270	57,441,849
1977	41,548,561	9,512,724	11,026,764	2,707,167	64,795,216
1978	46,017,123	10,428,913	11,558,867	2,981,007	70,985,910
1979	50,360,362	11,249,401	11,481,378	2,909,624	76,000,765
1980	55,063,529	11,902,744	11,327,382	3,048,393	81,342,048
1981	60,675,795	12,939,271	11,598,809	3,933,424	89,147,299
1982	68,602,104	14,236,031	13,163,602	4,451,938	100,453,675
1983	77,472,708	15,253,035	14,101,575	5,025,528	111,852,846
1984	86,651,697	16,114,837	13,985,426	4,244,111	120,996,071
1985	95,965,469	17,086,453	14,164,732	5,099,824	132,316,478

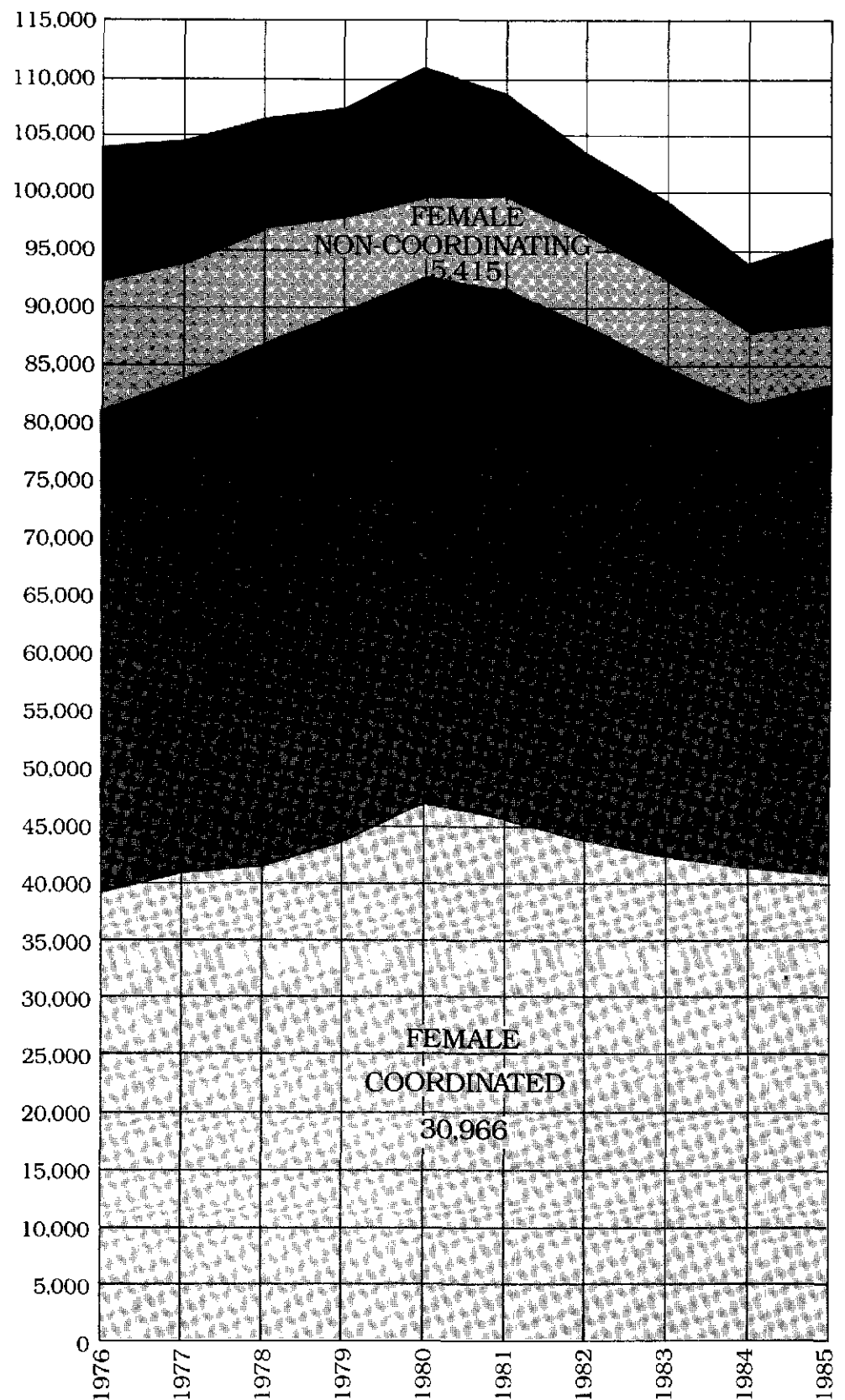
TOTAL MEMBERSHIP — COORDINATED/NONCOORDINATED

FY Ended June 30	COORDINATED MEMBERS			NONCOORDINATED MEMBERS			Total Male Members	Total Female Members	Total Members
	Male	Female	Total	Male	Female	Total			
1976...	42,925	39,047	81,972	11,260	11,439	22,699	54,185	50,486	104,671
1977...	43,032	40,158	83,190	10,829	10,675	21,504	53,861	50,833	104,694
1978...	44,516	42,297	86,813	10,342	9,863	20,205	54,858	52,160	107,018
1979...	45,310	43,705	89,015	9,824	9,109	18,933	55,134	52,814	107,948
1980...	46,029	46,626	92,655	9,339	8,446	17,785	55,368	55,072	110,440
1981...	45,713	46,153	91,866	8,876	7,775	16,651	54,589	53,928	108,517
1982...	43,764	44,376	88,140	8,315	7,096	15,411	52,079	51,472	103,551
1983...	42,009	42,122	84,131	8,024	6,585	14,609	50,033	48,707	98,740
1984...	40,547	40,136	80,683	7,338	5,915	13,253	47,885	46,051	93,936
1985...	42,349	40,966	83,315	6,977	5,415	12,392	49,326	46,381	95,707

ACTIVE MEMBERSHIP — COORDINATED/NONCOORDINATED

FY Ended June 30	COORDINATED MEMBERS			NONCOORDINATED MEMBERS			Total Male Members	Total Female Members	Total Active Members	Annual Earnings Reported
	Male	Female	Total	Male	Female	Total				
1976...	29,975	29,718	59,693	9,293	9,007	18,300	39,268	38,725	77,993	\$864,154,000
1977...	29,617	30,755	60,372	8,717	8,695	17,412	38,334	39,450	77,784	884,493,000
1978...	29,667	31,264	60,931	8,265	8,245	16,510	37,932	39,509	77,441	925,094,200
1979...	29,144	31,695	60,839	8,763	8,259	17,022	37,907	39,954	77,861	1,069,885,900
1980...	30,482	34,095	64,577	8,392	7,605	15,997	38,874	41,700	80,574	1,137,667,500
1981...	30,462	33,642	64,104	7,991	7,035	15,026	38,453	40,677	79,130	1,253,016,000
1982...	29,801	33,100	62,901	7,517	6,486	14,003	37,318	39,586	76,904	1,334,262,000
1983...	28,868	31,229	60,097	7,037	5,916	12,953	35,905	37,145	73,050	1,378,735,000
1984...	27,457	29,488	56,945	6,636	5,394	12,030	34,093	34,882	68,975	1,437,546,000
1985...	29,763	30,583	60,346	6,349	4,952	11,301	36,112	35,535	71,647	1,569,532,000

Total Membership- Coordinated/Noncoordinated



NUMBER OF RECURRING BENEFIT PAYMENTS

FY Ended June 30	Retirement Annuities	Survivors Annuities	Disability* Benefits	Total
1976	12,969	4,699	1,848	19,516
1977	13,885	5,228	1,920	21,033
1978	14,689	5,534	1,943	22,166
1979	15,560	5,894	1,976	23,430
1980	16,445	6,187	1,927	24,559
1981	17,307	6,485	1,871	25,663
1982	18,247	6,863	1,888	26,998
1983	19,306	7,139	1,851	28,296
1984	20,157	7,371	1,799	29,327
1985	20,969	7,626	1,734	30,329

*Includes individuals receiving total temporary disability payments under the Workers' Compensation Act.

TERMINATION REFUNDS — NUMBER/AMOUNT

1976	15,820	8,840,660
1977	14,055	10,988,479
1978	12,491	11,984,738
1979	14,354	11,900,531
1980	13,449	11,799,600
1981	12,171	11,810,898
1982	12,893	13,212,484
1983	10,252	13,149,550
1984	7,664	13,349,332
1985	5,638	12,339,874

SUMMARY OF RETIREMENT SYSTEM PLAN

(As of June 30, 1985)

1. PURPOSE

The State Employees' Retirement System of Illinois, a state agency, provides an orderly means whereby aged or disabled employees may be retired from active service without prejudice or hardship and enables the employees to accumulate reserves for old age, disability, death and termination of employment.

2. ADMINISTRATION

Responsibility for the operation of the System and the direction of its policies is vested in a Board of Trustees of five members. The administration of the detailed affairs of the System is the responsibility of the Executive Secretary who is appointed by the Board of Trustees. Administrative policies and procedures are designed to insure an accurate accounting of funds of the System and prompt payment of claims for benefits within the applicable statute.

3. EMPLOYEE MEMBERSHIP

All persons entering state service become members of the System after serving a six-month qualifying period unless their position is subject to membership in another state supported system. Any enrollee of the Young Adult Conservation Corps is excluded from membership. Administrative Code officers appointed by the Governor may elect to become members of the System.

4. MEMBER CONTRIBUTIONS

Members are required to contribute a percentage of salary as their share of meeting the cost of the various benefits. Contribution rates are as shown below:

- A. Members Coordinated With Social Security -4% of Salary
- B. Members Without Social Security -8% of Salary
- C. State Police, Special Agents, Firefighters, Secretary of State Investigators, Conservation Police Officers, Department of Revenue Investigators and Police Officer Positions (primarily Central Management Services) -9½% of Salary
- D. Full Time Security Employees of the Department of Corrections; Air Pilots –
 - (1) Coordinated with Social Security -5½% of Salary
 - (2) Without Social Security -9½% of Salary

Members coordinated with social security also pay the current social security tax rate.

5. RETIREMENT PENSION

A. Qualification of Member

Upon termination of state service, a member is eligible for a pension at age 60 with at least eight years of pension credit; at any age with 35 or more years of credit; between ages 55 and 60 with 30 to 35 years of credit with the pension reduced by one-half of 1% for each month the member is under age 60. Department of Corrections security employees must have at least 20 years of membership service to qualify for the special pension formulas which will apply only to the service earned while in a security position.

Members in Police, Firefighter and Air Pilot positions contributing 9½% of salary are eligible at age 50 with at least 25 years of pension credit or at age 55 with at least 20 years of pension credit in such a position.

B. Amount of Pension

The pension is based on the member's final average compensation and the number of years of pension credit that has been established.

The pension formula reflects a graded or progressive method according to length of service as follows:

Years of Credit	Employees Under Social Security	Employees Not Under Social Security	Full Time Security Employees – Dept. of Corrections Under S.S./Not Under S.S.		Special Formula, i.e., Police and other positions Under S.S./Not Under S.S.	
Each of the first 10 years of credit	1.0%	1.67%	1.67%	1.9 %	1.67%	2.25%
Each of the next 10 years of credit	1.1%	1.9 %	1.9 %	2.1 %	1.9 %	2.5 %
Each of the third 10 years of credit	1.3%	2.1 %	2.1 %	2.25%	2.1 %	2.75%
Each year above 30	1.5%	2.3 %	2.3 %	2.5 %	2.3 %	2.75%

The maximum pension payable is 75% of final average compensation.

C. Optional Forms of Payment

Reversionary Annuity – a member may elect to receive a smaller pension during his lifetime in order to provide a spouse or a designated dependent with a lifetime income. That payment would be in addition to any other benefit payable by the System. **Level Income** – A member who contributes to social security as a state employee may elect to have his pension payments increased before age 62/65 and reduced after that age to provide a uniform pension income throughout his retired life. To be eligible for this election the member must have established eligibility for a social security pension.

D. Annual Increases in Pension

Post retirement increases of 3% of the original pension are granted to members effective each January 1.

6. SURVIVORS ANNUITY

A. Qualification of Survivor

If death occurs while in state employment the member must have established at least 18 months of pension credit. If death occurs after termination of state service and the member was not receiving a retirement pension, the member must have established at least eight years of pension credit.

An eligible spouse qualifies at age 50 or at any age if there is in the care of the spouse any unmarried children of the member under age 18 or over 18 if mentally or physically disabled; unmarried children under age 18 if no spouse survives; dependent parents at age 50 if neither an eligible spouse nor children survive the member.

A spouse that is the sole nominated beneficiary and sole survivor may elect other death benefits in number 9 on page 39.

B. Amount of Payment

If the member's death occurs before retirement, the named beneficiary receives a lump sum refund of all the member's pension contributions plus interest credited to the members account, excluding contributions for widow and survivors benefits. A single lump sum payment of \$1,000 is also made immediately to the survivor beneficiary of the member.

An eligible spouse receives a monthly annuity equal to 30% of the member's final average compensation subject to a maximum of \$400. If children of the member are under the care of the spouse, the annuity is increased for each child, subject to a maximum of \$600. If only eligible children survive, the monthly annuity may not exceed the lesser of \$600 or 80% of final average compensation. The maximum combined monthly payment to parents may not exceed \$400. If the member's death occurs after retirement or after termination of state employment but before the member receives a pension, the monthly benefit is further limited

to 80% of the pension received or earned by the member. Monthly benefits payable to survivors of a member who was covered by social security as a state employee are reduced by one-half of the amount of benefits they are entitled to from social security as a widow(er). The minimum total survivor benefit payable to the survivors annuity beneficiaries of a deceased member or annuitant shall be 50% of the amount of retirement annuity that was or would have been payable to the deceased member on the date of death. If the minimum total benefit exceeds the maximum described above, the minimum shall be payable.

C. Duration of Payment

The monthly annuity payable to a spouse terminates upon death, or remarriage prior to attainment of age 55; to children upon death, marriage or attainment of age 18, except for a child who at age 18 is physically or mentally disabled and unable to accept gainful employment.

7. WIDOW'S ANNUITY OPTION

The widow of a male member who was a participant in the System prior to July 19, 1961, may have the option of taking a Widow's Annuity rather than the Survivor's Annuity.

A. Qualification of Widow

An eligible widow receives a Widow's Annuity if she is age 50 or over or has in her care any of the member's unmarried children under age 18. If she is not age 50 and has no such children in her care, she becomes eligible at age 50.

B. Amount of Payment

The Widow's Annuity consists of a lump sum payment of \$500, plus a monthly annuity equal to 50% of the pension earned or received by the member at the date of death. If the widow has in her care eligible children of the member, the monthly annuity is increased because of each child, subject to a maximum payment equal to 66 2/3 % of the earned pension. Monthly benefits payable to a widow of a member who was covered by Social Security as a state employee are reduced by one-half of the amount of benefits she is entitled to from social security as a widow.

C. Duration of Payment

The monthly payment to the widow continues for her lifetime whether or not she remarries. If the amount of benefit was increased because of eligible children it is adjusted downward as these children's benefits are terminated (death, marriage or attainment of age 18).

8. OCCUPATIONAL DEATH BENEFIT

A. Qualification of Survivors

If a member's death results from an injury on the job or a job related cause, the spouse may be eligible for an Occupational Death benefit. If only unmarried children under age 18 survive, they may be eligible for the benefit. If neither spouse nor eligible children survive, a dependent father or mother may be eligible.

B. Amount and Duration of Payment

The nominated beneficiary receives a lump sum payment consisting of all contributions made by the member plus interest credited to his account. A surviving spouse is entitled to a monthly benefit equal to 50% of the member's final average compensation. The benefit is payable until remarriage of the spouse unless the remarriage occurs after attainment of age 55. If children under age 18 also survive, the annuity is increased by 15% of such average because of each child subject to a maximum of 75%. If there is no spouse, or if the spouse remarries prior to attainment of age 55 or dies before all children have attained age 18, each child receives a monthly allowance of 15% of final average compensation.

The combined payment to children may not exceed 50% of the member's final average compensation. Payments to or on account of the children terminate upon their death, marriage or attainment of age 18.

If there is no spouse or eligible children, a benefit of 25% of final average compensation is payable to each surviving dependent parent for life.

The monthly benefit is reduced by any payments awarded under the Workers' Compensation or Occupational Diseases Acts.

9. OTHER DEATH BENEFITS

If the beneficiaries of the member do not qualify for any of the previously described death benefits, one of the following benefits is payable.

A. Before Retirement

If a member's death occurred while in state service the benefit consists of: (1) a refund of all contributions plus interest credited to the member's account; (2) a payment equal to one month's salary for each full year of pension credit not to exceed six month's salary. The minimum payment is equal to one month's salary.

If the member had terminated state service but not yet qualified for a pension the benefit consists of a refund of all of the member's contributions to the System plus the interest credited to the member's account.

B. After Retirement

The benefit consists of a lump sum payment equal to the excess of contributions plus interest credited to the member's account over the total amount of pension payments made to the member. The minimum payment is \$500.

10. NONOCCUPATIONAL DISABILITY BENEFITS

A. Qualification and Amount of Payment

Available to any member under age 70 who has established at least one and one-half years of creditable service and who has been granted a disability leave of absence by his employing agency. The benefit is 50% of final average compensation plus a credit to the member's account of service and contributions. It begins on the 31st day of absence from service on account of disability.

If the member has social security coverage as a state employee, the benefit payable by the System is reduced by the amount of any disability or retirement payment to which he is entitled under social security.

B. Duration of Payment

The member is eligible for the monthly benefit until the occurrence of any of the following events: (1) disability ceases; (2) resumption of gainful employment; (3) payments are made for a period of time equal to one-half of the pension credit established as of the date disability began; or (4) attainment of age 65, if benefit commenced prior to the attainment of age 60; or (5) the fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60, but not beyond age 70.

11. OCCUPATIONAL DISABILITY BENEFIT

A. Qualification and Amount of Payment

Provided for any member under age 70 who becomes disabled as the direct result of injury or diseases arising out of and in the course of state employment.

The benefit is 75% of final average compensation plus a credit to the member's account of

service and contributions. The cash benefit is reduced by any payment received under the Workers' Compensation or Occupational Diseases Acts.

B. Duration of Payment

Monthly benefits are payable until the occurrence of any of the following events: (1) disability ceases; (2) resumption of gainful employment; or (3) attainment of age 65, if benefit commenced prior to the attainment of age 60; or (4) the fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60, but not beyond age 70.

12. SEPARATION BENEFITS

Upon termination of state employment a member may obtain a refund of the contributions made to the System. By accepting a refund, a member forfeits all accrued rights and benefits in the System for himself and his beneficiaries.

LEGISLATIVE AMENDMENTS

Amendments with an effective date during fiscal year 1985 having an impact on the System were:

HOUSE BILL 2509 –

This bill changes many boards and commissions by requiring that a senior citizen age 60 or over be included on the boards. The Board of Trustees of the State Employees' Retirement System makeup would be changed so that the next employee member vacancy would be filled by an annuitant age 60 or over. The size of the board would remain the same. This bill was effective December 11, 1984.

HOUSE BILL 3093 –

This bill changes the State Employees' Group Insurance Act to provide that individuals who have begun receiving retirement benefits within one year of receipt of their final compensation will be eligible to participate in the Group Life Insurance Program. This bill was effective September 11, 1984.

SENATE BILL 1876 –

This bill changes the alternative retirement formula section of the Retirement Act to provide for the inclusion of Central Management Services security police officer positions. This Act defines those positions and provides that they will be included in the special retirement formula. This bill was effective July 17, 1984.

NEW LEGISLATION with effective dates subsequent to June 30, 1985, affecting the operation of the System is summarized below.

HOUSE BILL 1445 –

This bill changes retirement benefits for Department of Corrections security employees by placing these employees under the alternative formula (State police, Conservation police, etc.). The age and service requirements in accordance with the alternative formula will be phased in over a five year period.

This bill also changes the 3% automatic increase benefit for individuals retiring under the alternative formula so that these benefits will begin on the January 1st following the later of attainment of age 55 or one year after retirement. Effective August 16, 1985.

HOUSE BILL 1966 –

This bill changes provisions of the Retirement Act which allow Administrative Code Officers to elect or reject participation in the Retirement System. It changes the definition of those affected to include all individuals who are appointed by the Governor and confirmed by the Senate. Effective September 23, 1985.

The changes in this bill affecting the State Employees' Retirement System are as follows:

Widow's Annuity benefits will be extended to the widow of an individual who retired prior to August 1953 and who died after January 1, 1985.

The composition of the Board of Trustees of the System will be changed by adding two additional members. One new member will be an annuitant elected by the retirees and the other an employee with eight or more years of service elected by the active members.

Disability recipients who have been receiving benefits for four years will receive a one-time cost of living adjustment of 7% on January 1, 1986. This provision will also affect future disability benefit recipients by providing for the adjustment on the January 1st after they have received disability benefits for four years.

Service credit granted for unused sick pay will be included to determine eligibility for a retirement annuity. This change will treat credit for unused sick pay the same as credit which is established based on compensated sick pay.

Code Officers who elected not to participate, but subsequently do become members and desire to establish credit for the previous service will be allowed to do so upon payment of contributions and interest.

Currently, an employee who has filed legal action seeking reemployment cannot receive a refund of his contributions. This bill allows the payment of such refund upon the request of the member.

A new temporary disability benefit is established and is payable when a member is initially denied Workers' Compensation benefits and is appealing such denial. Currently the Retirement System is prohibited from making any payment until a determination is made. This bill provides for payment at the nonoccupational rate, 50% of pay, providing all eligibility requirements for the nonoccupational benefit are met, until the determination is made. This change further provides for the recovery of any excess payments made under this provision from any Workers' Compensation or Occupational Diseases award. Effective November 18, 1985.